Conference Title: FY2022 Second Quarter Investor Call

Date: Tuesday, 25 January 2022

Operator:

Good afternoon, and welcome to National Rural Utilities Cooperative Finance Corporation's Fiscal Year 2022 Second-Quarter Investor Conference Call. I'll now turn the call over to Heesun Choi, Director, Capital Market Relations.

Heesun Choi:

Good afternoon. 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 second-quarter investor call today.

Joining our call this afternoon 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 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 and forward 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 filed with the U.S. Securities and Exchange Commission. All the forward-looking statements are made as of today, January 25, 2022, and

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 statements are made.

Today's discussion will include certain non-GAAP measures. Please refer to our Form 10-Q filed on January 14, 2022, with the SEC and also posted on our website for a discussion of why we believe our adjusted measures provide useful information in analyzing CFC's financial performance and reconciliations to the most comparable GAAP measures.

We will open the call for Q&A at the end of the 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.

Today's presentation slides and financial reports are available on our website in our Investor Relations page on our website at www.nrucfc.coop. A replay and call transcript will also be made available in our Investor Relations page after this event.

With that, I will turn this call over to Andrew for his call remarks.

Andrew Don:
Thank you, Heesun. Good afternoon. This is Andrew Don, the Chief Executive Officer of CFC. Thank you for joining us today. I'm pleased to share that CFC continues to have strong operating and financial results, and we will review our financial highlights for the second fiscal quarter of 2022, as well as an update on our business and operations.

Before we begin a review, I'd like to take a few minutes discussing current trends that electric cooperatives are currently engaged in. There are currently four key trends that are developing for electric cooperatives. Those being: a continued investment in broadband; a growing focus on electric system

resiliency; evolving relationships between some G&Ts and distribution cooperatives; and beneficial electrification.

These trends all indicate a strong future for our member cooperatives and steady demand for capital to support these investments. For broadband, there's continuing substantial investment into broadband projects by CFC member systems. We are tracking 182 broadband projects each by different cooperatives. CFC is financing 93 of the 182 projects with an aggregate loan volume of more than $1 billion to-date.

When the 182 projects are fully completed, they will equate to approximately $8.6 billion of capital expenditures. The 93 projects CFC financed will equate to $4.6 billion, or 53%, of the $8.6 billion total expenditures. Many of the projects are also supported financially by various state and federal programs, which is a positive for our member electric cooperatives and CFC.

Electric cooperatives are also focused on investing in electric system resiliency. We are seeing increased capital investment in this area to replace systems after damage is caused by weather-related incidents, including hurricanes and winter storms and to proactively strengthen existing electrical systems. The impact on electric systems by various storms, wildfires and weather-related incidents over the last few years has increased utility awareness and the willingness to make needed investments in resiliency.

A relatively small number of cooperatives are looking to reassess or redefine their contractual arrangements between distribution cooperatives and generation and transmission cooperatives. These discussions are largely focused on ways to increase investments in renewable power supply.

The final trend that we are experiencing is beneficial electrification, which is the effort to replace fossil fuels such as gasoline, propane and heating oil with electricity. The obvious example of this is the electrification of vehicles for fleets and consumers. This trend has significant implications for all electric

utilities and will require significant investment in infrastructure and planning to service the expected growth in overall electricity loads.

We continue to experience steady organic growth in our balance sheet supported by strong loan demand, primarily for our electric members. Over the past decade, our balance sheet has expanded by nearly $10 billion, passing the $30 billion mark during the six months ended November 30, 2021.

Our loans to members increased by $520 million, or 2%, to $28.9 billion compared with $28.4 billion at the fiscal year-end 2021. The increase in loans to members was attributable to mainly an increase in CFC distribution loans of $531 million, partially offset by a decrease in CFC power supply loans of $32 million. Long-term loan advances totaled $1.5 billion during the six months ended November 30, 2021, of which approximately $1 billion, or 69%, was provided to members for capital expenditures, and approximately $437 million, or 29%, was provided to members for operating expenses or to refinance line of credit advances that were made to meet elevated power cost obligations incurred during the February 2021 polar vortex.

We continue to 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. 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've had no charge-offs in the electric portfolio since 2013, and we did not have any additional non-performing or restructuring loans during the current fiscal year to-date.

We also believe that the overall credit quality and financial position of electric cooperatives continues to be sound and strong.

From an operating performance perspective, our financial position remains strong as shown by consistently solid financial metrics. Our adjusted TIER was 1.29 times during the six months ended

November 30, 2021, which was well above our goal of 1.1 times and represented a 6.5% increase from the 1.24 times lower from the prior-year quarter.

Our adjusted debt-to-equity ratio was 6.15 times to 1, which was unchanged from the level as of May 31, 2021, and aligned with our corporate goal of maintaining approximately 6 times to 1. Our liquidity position continues to be healthy as we maintain diverse funding sources to minimize the risk of being dependent on any single source or market. As of November 30, 2021, our 12-month liquidity coverage ratio was 2.3 times, including scheduled loan repayments and excluding member short-term investments.

With that, I now want to turn this call over to Ling, who will review our financial results for the second fiscal quarter of 2022 in more details. Thank you.

Ling Wang:
Good afternoon. This is Ling Wang. For those of you who are on the phone, I am on slide eight.

Our total assets at quarter ended November 30, 2021, were approximately $30 billion, a slight decrease of $76 million, or 0.3%, from the prior quarter-end, but an increase of $377 million, or 1.3%, from $29.6 billion at the fiscal year-end of 2021. The increase in our total assets during the first six months of fiscal year was primarily driven by increasing loans to members largely due to loan advances during the first quarter of this fiscal year.

Loans to members totaled $28.9 billion as of November 30, 2021, an increase of $64 million, or 0.2%, from the prior fiscal quarter-end, and an increase of $520 million, or nearly 2%, from May 31, 2021, our prior fiscal year-end. The $520 million increase in loans to members during the six-month period reflected a net increase in long-term loans of $530 million, partially offset by a net decrease in line of credit loans of $10 million. We continue to experience steady loan demand from our members.

Our long-term loan advances during the current fiscal quarter totaled nearly $779 million with approximately $593 million, or 76%, of those advances made for capital expenditure purposes, and nearly $184 million, or 23%, for operating expenses. For the prior quarter, our long-term loan advances totaled $727 million, consisting of $450 million, or 62%, for capital expenditure purposes and $255 million, or 35%, for members' operating expenses, primarily due to increased power cost and natural gas price during the February 2021 winter storm.

As Andrew mentioned earlier, given the prolonged low interest rate environment over the past several years, many of our members have locked in at or near historic low interest rates on their long-term loans for extended terms. As a result, the amount of long-term fixed-rate loans that we priced during each fiscal year over the last five fiscal years have gradually declined from $1 billion in fiscal year 2016 to $397 million in fiscal year 2021.

As of November 30, 2021, our long-term fixed-rate loans scheduled to reprice over the next 12 months, totaled $343 million and long-term fixed-rate loans scheduled to reprice over the next 4.5 fiscal years totaled $1.4 billion, representing an average of $309 million per fiscal year. Our members' equity, which excludes cumulative derivative forward value losses and accumulated other comprehensive income, increased by $64 million, or 3%, from the prior quarter due to an adjusted net income of $64 million for the current quarter.

For the fiscal year to-date, our members' equity increased by $61 million from May 31, 2021 as a result of an adjusted net income of $118 million for the six months ended November 30, 2021, which was partially offset by the CFC Board of Directors authorization in the first quarter to retire patronage capital of $58 million.

Our adjusted debt-to-equity ratio was at 6.15-to-1 at November 30, 2021, a decrease from 6.27-to-1 at August 31, 2021, and unchanged from the level as of May 31, 2021. The decrease in the adjusted debt-to-equity ratio from the prior quarter was primarily due to an increase in adjusted net income.

While our goal is to maintain an adjusted debt-to-equity ratio of approximately 6-to-1, we expect that our adjusted debt-to-equity ratio will remain elevated slightly above our target of 6-to-1 in the near term due to the projected increase in total debt outstanding to fund anticipated growth in our loan portfolio.

For the current quarter ended November 30, 2021, CFC generated an adjusted net income of $64 million and an adjusted TIER of 1.32 times, compared with adjusted net income of $49 million and an adjusted TIER of 1.24 times for the same prior-year quarter. The $15 million, or 29%, increase in adjusted net income in the current quarter from the same prior-year quarter was driven by an increase in adjusted net interest income of $11 million, or 16%, to $84 million for the current quarter, and a favorable shift in our provision for credit losses of $5 million.

The $11 million, or 16%, increase in adjusted net interest income during the current quarter was driven by an increasing adjusted net yield of 8 basis points, or 8%, to 1.13% and an increasing average interest-earning assets of $1.9 billion, or 7%. The increase in adjusted net interest yield reflected this favorable impact of a reduction in our adjusted average cost of bond of 27 basis points to 2.89%, partially offset by a decrease in the average yield on our interest-earning assets of 17 basis points to 9.84%.

For the six months ended November 30, 2021, CFC generated adjusted net income of $118 million and an adjusted TIER of 1.29 times, compared with an adjusted net income of $107 million and an adjusted TIER of 1.26 times for the same prior-year period. The $11 million, or 10%, increase in adjusted net income for the six-month period from the comparable prior-year period was primarily driven by an increasing adjusted net interest income of $20 million, partially offset by an unfavorable shift in the unrealized gains and losses of $10 million recorded on our investment securities.

The $20 million, or 14%, increase in adjusted net interest income during the current six-month period was driven by increase in the adjusted net interest yield of 7 basis points, or 7%, to 1.11% and an increase in average interest-earning assets of $1.7 billion, or 6%. The increase in adjusted net interest yield reflected

the favorable impact of a reduction in our adjusted average cost of funds of 25 basis points to 2.91%, partially offset by a decrease in average yield on interest-earning assets of 16 basis points to 3.84%.

The overall composition of our loan portfolio at November 30, 2021, remained unchanged from the composition at May 31, 2021, with $28.5 billion, or 99%, of our loan portfolio consisting of loans to rural electric systems and $432 million, or 1%, to the telecommunication sector. The percentage of CFC's long-term fixed-rate loans was at 90% of total loans as of November 30, 2021, unchanged from the May 31, 2021 level. We typically lend to our members on a senior secured basis with 94% of our loans being senior secured as of November 30, compared with 93% as of May 31, 2021.

We offer long-term loans to our members for up to 35 years on a senior secured basis. The average remaining maturity of our long-term loans, which accounted for 92% of the total loans outstanding as November 30, 2021, was 18 years.

During the current quarter and for the six-month period, we did not have any loan charge-offs. Prior to Brazos Electric Power Cooperative's bankruptcy filing in March 2021, we had not experienced any loan defaults or charge-offs in our electric utility and telecommunication loan portfolios since fiscal year 2013 and 2017, respectively. We have loans to two borrowers, totaling $219 million, or 0.76%, of total loans outstanding, classified as non-performing as of November 30, 2021. In comparison, we had loans to four borrowers, totaling $237 million, or 0.84%, of total loans outstanding, classified as nonperforming as of May 31, 2021.

The $18 million decrease in non-performing loans is attributable to, number one, a full repayment of two non-performing telecommunication loans, totaling $9 million; and number two, the continued payment of an existing non-performing power supply loan of $9 million. As of November 30, 2020, all of our loans performing or non-performing are current, except for the $86 million loans outstanding to Brazos Electric Power Cooperative.

Our allowance for credit losses was $86 million as of both November 30 and May 31, 2021, reflecting the offsetting impact of an increase in the collective allowance of $4 million and a decrease in the asset-specific allowance of $3 million, which was the result of the $9 million non-performing loan payments that I mentioned earlier. Our allowance coverage ratio was 30 basis points at both November 30 and May 31, 2021.

As discussed in prior calls, the Winter Storm Uri had adverse financial impact on two of our power supply borrowers, Brazos and Rayburn Country Electric Cooperative. As of November 30, 2021, our outstanding loan exposure to Brazos and Rayburn was $86 million and $371 million, respectively. The state of Texas enacted securitization legislation in June of 2021 that offers financing programs for qualifying electric cooperative exposure to elevated power costs during Winter Storm Uri.

Brazos and Rayburn both qualified for the Texas enacted financing program. Rayburn has initiated the securitization financing process to raise funds for eligible costs incurred during the winter storm, as specified in the legislation, and has stated that it intends to use the process to pay down its related outstanding obligation to the Electric Reliability Council of Texas, also known as ERCOT.

On January 18, 2022, Moody assigned a provisional rating of AAA to three tranches of senior secured cost-recovery bonds to be issued by Rayburn Country Securitizations, LLC. It is expected that Rayburn will use the process from the securitization to pay for the costs and expenses incurred during the Winter Storm Uri, including outstanding amounts owed to ERCOT. We also expect that Rayburn will use the proceeds to pay down a portion of its line of credit outstanding with us.

There are many factors which we are unable to predict that may impact the completion and outcome of the securitization transaction and the ultimate collectability of Rayburn's loan outstanding. As of November 30, 2021, our loans outstanding to Rayburn consisted of secured loans totaling $159 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 November 30, 2021, an increase of $364 million, or 1%, from $27.4 billion as of May 31, 2021, primarily to fund the growth in our loan portfolio. 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 November 30, 2021, $4.91 billion of CFC's funding came from our members in the form of short-term and long-term investments, a slight decrease of $61 million from $4.97 billion at May 31, 2021. Our member investments represented 18% of our total debt outstanding at both November 30 and May 31, 2021.

At November 30, 2021, our funding under the Guaranteed Underwriter Program and notes payable with Farmer Mac totaled $9.4 billion, or 34%, of our total debt outstanding, an increase of $165 million from May 31, 2021, primarily due to the $450 million new borrowings under the Farmer Mac notes purchase program, partially offset by maturity and scheduled principal payment and amortization on both programs.

Our capital markets-related funding sources totaled $13.5 billion at November 30, 2021, an increase of $260 million from May 31, 2021. The increase was primarily due to a net increase of $463 million in dealer medium-term notes outstanding, a net increase of $145 million in dealer commercial paper outstanding, and an increase of $49 million in secured borrowings on the repurchase agreement, partially offset by an early redemption of $400 million of collateral trust bonds.

As both November 30 and May 31, 2021, capital markets-related funding sources accounted for 48% of our total outstanding.

At November 30, 2021, 59% of our total debt was secured and 41% was unsecured compared with 61% and 39% from May 31, 2021, respectively. The increase in the unsecured debt outstanding was due to our issuances of $750 million in dealer medium-term notes in October 2021. Our short-term borrowings

increased by $165 million to $4.7 billion, accounting for 17% of our total debt outstanding at November 30, 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 an increase in dealer commercial paper outstanding. A total of $3.5 billion, or 73%, of our short-term borrowings came from our members' short-term investments at November 30, 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 and with very little reinvestment risk, as our members consistently invest a large portion of their excess funds with CFC.

This slide represents CFC's long-term debt maturities and amortizations over the next 12 months from January 2021 to January 2022. Our upcoming debt payment obligations consist of $455 million in collateral trust bonds, $850 million in dealer medium-term notes, $664 million in Farmer Mac notes payable and $516 million in Guaranteed Underwriter Program.

Excluding our member medium-term notes maturity, which have traditionally been reinvested with us, we have approximately $2.6 billion of refinancing needs over the next 12 months from January 2022 to December 2022. We plan to look to utilize both capital markets and non-capital market funding sources to refinance upcoming maturities in due course.

This slide shows the various sources of liquidities that CFC had in place at November 30, 2021. At November 30, 2021, our available liquidity from various sources includes cash and cash equivalents, committed bank lines, investments, Guaranteed Underwriter Program and Farmer Mac's revolving notes purchase agreement, which totaled $7.1 billion. Our available liquidity includes an additional $550 million commitment under the Guaranteed Underwriter Program, which we closed in November 2021.

In addition, we expect to receive $1.5 billion from our members for scheduled repayment on long-term loans over the next 12 months. As indicated in the table, excluding our members' short-term debt

maturities, we had approximately $3.8 billion of debt maturities over the next 12 months as of November 30, 2021. These debt maturities consist of short-term debt of $1.3 billion and long-term debt and subordinated debt obligations of $2.5 billion.

As of November 30, 2021, short-term investments from our members totaled of $3.5 billion. Because our members have traditionally rolled over a large portion of their short-term investments with us at maturity, we consider our member investments to be a very reliable and stable source of funding for CFC. If we exclude $3.5 billion of debt maturities related to our members' short-term investments, we will have a total liquidity equal to 1.9 times, or $3.3 billion, of liquidity in excess of our debt maturities during the next 12 months subsequent to November 30, 2021.

Together with the $1.5 billion scheduled long-term loan principal repayment over the next 12 months, our excess liquidity would have been 2.3 times or $4.8 billion to meet our debt maturities in the next 12 months, subsequent to our current quarter-end compared with 2.5 times, or $5.3 billion, as of May 31, 2021.

This slide summarizes CFC's projected long-term debt issuance needs over the next 18 months, subsequent to November 30, 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 months period to be approximately $1.3 billion. As indicated in the last column, our expected long-term debt issuances other than this time period are approximately $4 billion, mainly to refinance existing long-term debt. Also note that other sources and uses of cash column in the middle of the slide reflects the net increase or decreases to our dealer commercial paper and other short-term debt outstanding, and purchases and maturities of investment.

To meet our funding needs, we will continue to look to balance capital markets and non-capital markets secured and unsecured financing, 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. CFC's credit ratings from Fitch, Moody's and S&P remain strong and stable at A-plus, A1 and A-minus on a senior secured basis and A, A2 and A-minus on a senior unsecured basis, respectively. All of these rating agencies have affirmed our credit ratings and outlook during the last quarter in calendar year 2021.

The overall quality of our loan portfolio continues to be strong with 99% of our loans to rural electric systems and 94% of our loans being on a senior secured basis. We have not had 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 founding source. Our total member investments have averaged nearly $5 billion during the current fiscal year compared with $4.2 billion at our fiscal year-end 2016. Our members' equity has grown by 46% to $1.9 billion from $1.3 billion since May 31, 2016, as we are committed to grow our equity to retain earnings.

We continue to maintain diversified 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 ended November 30, 2021. We appreciate your interest in CFC and look forward to discussing our financial performance and funding plans in the future.

Now, I would like to ask the operator to open the line for questions, and also suggest that you submit your questions via the web service, so we may respond to those questions as well. Thank you.

Operator:

If you'd like to ask the question over the phone, please signal by pressing star one on your telephone keypad. Please ensure the mute function on your telephone is switched off to allow your signals to reach our equipment. Again, it is star one to ask a question over the phone.

Ling Wang:

Okay. We do have one question from the web. What is the expected amount carved for NRUC outstanding from Rayburn securitization? As I mentioned in the call, we have approximately $212 million of unsecured exposure to Rayburn as of November 30, 2021. I would say a fairly large portion of that unsecured outstanding was funding that's related to the additional power costs that Rayburn has incurred during the winter storm.

Operator:

And as a reminder, it is star one to ask a question over the phone. We have no questions over the phones.

Heesun Choi:

Okay. We do not see any questions from the web either.

Ling Wang:

Okay. And then thank you for participating in today's call. And if you have any questions, please feel free to contact myself or Heesun Choi after the call. We can end the conference now.

Heesun Choi:

Thank you, operator.

Operator:

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