

**National Rural Utilities Cooperative Finance Corporation
Fiscal Year 2018 Results**

**August 07, 2018
11:00 AM EDT**

Operator: Good day and welcome to the FY2018 year-end investor call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ling Wang. Please go ahead.

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 fiscal year 2018 financial results. Andrew Don, our Senior Vice President and Chief Financial Officer, will discuss our fiscal year 2018 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. These 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 that the 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 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 material for this event, including the presentation slides and financial reports, are available on our website at nrucfc.coop. A replay and a call transcript will be made available on our website after the event.

With that, I will turn the call over to Andrew.

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 fiscal year ended May 31, 2018.

We provide our results based on Generally Accepted Accounting Principles, or GAAP, in our fiscal year 2018 Form 10-K, which we filed on July 31, 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-K. 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.

Fiscal year 2018 was another solid year for CFC. Although loan growth was more moderate during fiscal year 2018 compared with prior years, we continued to experience strong loan demand from our members. Over the last five fiscal years the compound annual growth rate of our electric loan portfolio has been approximately 5%.

Similar to fiscal year 2017, loan advances during fiscal year 2018 were primarily for capital expenditures. Specifically, during the most recent fiscal year CFC's total long-term loan advances were \$2.2 billion. Approximately 67% of those new advances were for capital expenditures, 24% were made to refinance other lenders' loans, and 9% were for acquisition and other purposes.

CFC continued to add new 100% borrowers during fiscal year 2018. At May 31, 2018 CFC had 235 100% borrowers, an increase of 11 from the prior fiscal year end. CFC 100% borrowers represent those members who have 100% of their long-term funding needs sourced exclusively from CFC.

Since most of our electric borrowers are private companies, it is difficult to definitively determine the actual size of the rural electric lending market based on public information. We therefore estimate the size of the overall rural electric lending market from annual financial and statistical reports our members provide to us on a calendar year basis. Based on the most current available information, we estimated that our market share at December 31, 2017, in terms of long-term loans outstanding in the electric cooperative space was approximately 24%, a slight increase from December 31, 2016. We continue to be the single largest private lender in the electric cooperative sector.

Turning to our financial results, total assets increased by \$1.5 billion or 6% during this fiscal year, primarily due to the growth in our loan portfolio of \$812 million and an increase in our held-to-maturity investment securities of \$520 million. The \$812 million increase in our loan portfolio in fiscal year 2018 was driven by an increase in CFC distribution loans of \$726 million, an increase in NCSC loans of \$173 million, and an increase in RTFC loans of \$9 million, with these increases partially offset by a decrease in CFC power supply loans of \$107 million.

Total debt outstanding increased by \$1.2 billion or 5% in fiscal year 2018, primarily to fund growth in our loan portfolio.

Total equity increased by \$407 million, mainly due to net income of \$457 million for fiscal year 2018, partially offset by the retirement of patronage capital of \$45 million.

At fiscal year-end, our members' equity, which excludes the non-cash impact of derivative forward value gains and losses, accumulated other comprehensive income, and non-controlling interests, increased by \$108 million due to adjusted net income of \$151 million, partially offset by the patronage capital retirement of \$45 million.

Our adjusted debt-to-equity ratio stood at 6.18 to 1 at May 31, 2018. The increase was largely due to an increase the debt outstanding to fund the loan growth.

In July, 2018, subsequent to our May 31, 2018 fiscal year end, our Board of Directors authorized the retirement of patronage capital totaling approximately \$48 million, which represented 50% of the patronage capital allocation for fiscal year 2018. We expect to return this amount to our members in cash during the first fiscal quarter of fiscal year 2019, which will impact our equity and member equity amounts for that quarter. The remaining 50% of the allocated amount will be retained by CFC for 25 years. This practice is consistent with the guidelines adopted by our Board of Directors in 2009.

Over the next 12 months, we expect that our balance sheet will continue to grow. We also expect we will continue to increase our members' equity through the accumulation and retention of earnings. Due to anticipated asset growth, we expect our adjusted debt-to-equity ratio to be above the 6 to 1 target over the next 12 months.

For fiscal year 2018, CFC generated an adjusted TIER of 1.17 times, compared with an adjusted TIER of 1.16 times for fiscal year 2017. Our adjusted net income totaled \$151 million for fiscal year 2018, compared with \$133 million for the prior fiscal year. The \$18 million increase in adjusted net income for the current fiscal year over the prior fiscal year was primarily driven by the favorable shift in the provision for loan losses of \$24 million, partially offset by an increase in operating expenses of \$5 million.

During fiscal year 2018, we recorded a benefit for loan losses of \$18 million, compared with a provision for loan losses of \$6 million in fiscal year 2017. The benefit for loan losses was attributable to a reduction in our allowance for loan losses due to an increase in the recovery rate assumptions used in determining the collective allowance for our electric distribution and power supply loan portfolios to reflect our current assessment of expected losses in the event of a loan default in these portfolios. Generally speaking, over 90% of our loans are made on a senior secured basis, and historically we have experienced on average a very high recovery rate if a payment default has occurred.

We continue to experience strong credit performance in our electric utility loan portfolio. Specifically, we have experienced no payment defaults, charge-offs, delinquent loans, or non-performing loans in the electric utility portfolio for five consecutive fiscal years.

Our adjusted net interest income of \$210 million for fiscal year 2018 was flat compared with the prior fiscal year, reflecting the combined impact of a decrease in our adjusted net interest yield that was offset by an increase in our average interest-earning assets.

Our adjusted net interest yield decreased by 3 basis points from the prior fiscal year to 83 basis points, primarily attributable to an increase in our overall average cost of funds due to increases in our short-term and variable rate funding costs. Our average interest-earnings assets increased by 3% during fiscal year 2018. We expect our adjusted net interest yield and adjusted net interest income to improve over the next 12 months as a result of a projected decrease in our long-term funding costs, and a further increase in average outstanding loans.

CFC recorded \$306 million of derivative forward value gains during fiscal year 2018, compared with \$179 million of gains in the prior fiscal year. The derivative forward value gains in each fiscal year were attributable to an increase in the fair value of our pay

fixed interest rate swaps as interest rates continued to rise across the yield curve over the past two fiscal years. The increase in interest rates, however, was more pronounced during the current fiscal year, which resulted in significantly higher derivative gains relative to the prior fiscal year.

As we have regularly disclosed, the derivative forward value gains or losses reflect the changes in estimated fair value of our interest rate swaps at the end of each reporting period, based on the projected movement in interest rates through the maturity of the swap transactions in place at the end of each period. These amounts do not represent current period realized cash gains or losses. Therefore, as previously noted, 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 fiscal year end May 31, 2018, remained largely unchanged from the composition at the prior fiscal year end, with \$25 billion or 99% of our portfolio consisting of loans to rural electric systems, and \$363 million or 1% to the telecommunications sector.

The percentage of CFC's long-term, fixed-rate loans was at 90% as of May 31, 2018, compared with 91% at May 31, 2017. We typically lend to our members on a senior secured basis, with 93% of our loans being senior secured at May 31, 2018, compared with 92% at May 31, 2017.

This slide depicts CFC's consolidated loans outstanding by state, and the states with the largest overall loans outstanding increases during fiscal year 2018. Overall, we experienced loan demand for both term loans and revolving line of credit loans and as mentioned earlier, approximately 67% of our new long-term loan advances during fiscal year 2018 were made for capital expenditures.

We continue to have our largest concentration of outstanding loans and borrowers in Texas, which accounts for approximately 15% of total loans outstanding, comprised of 70 borrowers at May 31, 2018. During fiscal year 2018 we experienced robust capital expenditure loan demand from borrowers in Texas due to strong economic growth in that state. Specifically, Texas accounted for approximately 23% of our loan growth in fiscal year 2018.

Florida accounted for our second-largest loan growth during fiscal year 2018; however, most of the loan growth in Florida came from increases in revolving line of credit loans from electric distribution cooperatives that were impacted by Hurricane Irma in late August to early September of 2017. By comparison, loan growth in Kansas, which was the third-largest state in loan growth in fiscal year 2018, was mainly driven by term loan demand for capital expenditures; in particular, transmission-related expenditures.

In terms of single borrower concentration, as of May 31, 2018, our largest exposure to a single borrower represented approximately 2% of total loans outstanding, while our top 20 borrowers represented 22% of total loans outstanding, or \$5.6 billion. Our top 20 borrowers consisted of 9 distribution systems, 10 power supply systems, and 1 NCSC associate member, which is an electric utility company owned by several distribution systems.

We have a long-term, standby purchase commitment agreement with the Federal Agricultural Mortgage Corporation, also known as Farmer Mac. Under this agreement CFC may designate certain loans, as approved by Farmer Mac and in the event any such loan later goes into payment default for at least 90 days, upon request by CFC, Farmer Mac must purchase such loan at par value. At May 31, 2018, loans to our top 20

borrowers covered under this agreement totaled \$355 million. As a result, our net loans outstanding exposure to this group of borrowers was reduced to \$5.3 billion, or 21% of total loans outstanding.

During fiscal year 2018 and at May 31, 2018, we had no delinquent or nonperforming loans in our loan portfolio. We had no charge-offs during fiscal year 2018. The credit quality of our loan portfolio remains strong, with our members continuing to demonstrate solid financial and operational performance. This is especially true for our electric utility portfolio as we have experienced a sustained period of five consecutive fiscal years for which we have had no credit losses in our electric utility portfolio.

CFC continues to maintain diverse funding sources so as to minimize the risk of being dependent on any single source or market. At May 31, 2018, \$4.4 billion or 18% of CFC's funding came from our members in the form of short-term and long-term investments. Our member investments are stable and reliable, offering CFC funding with little reinvestment risk as our members have historically and consistently invested a large portion of their excess funds with CFC.

At May 31, 2018, the total outstanding balance under the Guaranteed Underwriter Program, which is our federal government-based funding source, and our notes payable with Farmer Mac, increased by \$243 million from the prior fiscal year end. The increase was driven by a \$378 million increase in notes payable with Farmer Mac, offset by a decrease of \$129 million in outstandings under the Guaranteed Underwriter Program.

Our capital markets related funding sources, which represented 51% of our total funding, increased by \$708 million at May 31, 2018 from the May 31, 2017 year end date to fund the asset growth. The increase was driven by an increase in our unsecured dealer medium-term notes outstanding.

This slide presents CFC's long-term debt maturities from August 2018 through August 2019. As indicated, our total long-term debt maturities over this period are expected to be \$2.8 billion, with collateral trust bonds accounting for approximately \$1.5 billion or 54% of the scheduled debt maturities. Our other significant debt maturities during this period, include a \$250 million bullet note with Farmer Mac maturing in September 2018, and the \$350 million dealer medium-term note maturing in April 2019. With respect to the \$462 million of 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 the maturities, as is highlighted in the next slide.

This slide depicts the various non-capital market dependent sources of liquidity that CFC had in place at May 31, 2018, compared with the fiscal year ended May 31, 2017. During fiscal year 2018 we proactively strengthened our liquidity position further to include a diversified basket of held-to-maturity, U.S. denominated, short to intermediate term investment grade fixed income securities. In addition, we increased the specific sources of liquidity from both the Guaranteed Underwriter Program and Farmer Mac.

At May 31, 2018, the aggregate amount of sources of liquidity CFC had totaled \$9.2 billion, compared with \$7.9 billion at May 31, 2017. The \$1.3 billion increase was primarily driven by a \$500 million increase in availability under the Guaranteed Underwriter Program, a \$322 million increase in availability under the two revolving Farmer Mac note purchase agreements, and a \$520 million increase in held-to-maturity investment securities, offset by an \$82 million decrease in bank revolving line of credit facilities. In addition to the liquidity sources already mentioned, we also had \$1.4 billion of scheduled loan amortization and repayments expected over the next 12 months, from May 31, 2018.

At May 31, 2018, CFC had an aggregate of \$6.6 billion of member and non-member debt maturities over the next 12 months, compared with \$4.6 billion at May 31, 2017. The \$2 billion difference was primarily due to a larger maturity amount of current portion of long-term debt.

At May 31, 2018, CFC had access to \$2.7 billion, or 1.4 times the liquidity greater than the combined member and non-member short-term debt maturity needs. The \$6.6 billion of debt maturities over the next 12 months includes \$2.8 billion of short-term investments that our members have with CFC.

As mentioned earlier, we consider our member investments to be a very stable and reliable source of funding for CFC. If we were to exclude short-term debt maturities related to our member investments, we would have access to \$5.5 billion, or 2.5 times of liquidity greater than our non-member short-term debt 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, 2018.

This slide presents CFC's projected sources and uses of cash over the next 18 months from May 31, 2018. As indicated, our total projected cash needs over this time period are approximately \$6.6 billion, with 42% of this amount expected to satisfy projected new loan advances and 58% to meet maturities of long-term debt. Overall, we expect growth in our long-term loan portfolio of \$746 million over the next 18 months.

Our 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.

As indicated on this table, we have a significant refinancing requirement for the remainder of calendar year 2018. That said, we believe we have multiple funding sources that we may use cost effectively. 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.

During fiscal year 2018, we have completed a variety of funding transactions. Most of these transactions have been mentioned in our prior investor calls. From the borrowing capacity perspective, we extended the maturity dates of our bank revolving credit facilities, increased the availability and extended the draw period for one of our revolving note purchase agreements with Farmer Mac, and expanded our capacity for borrowings under the Guaranteed Underwriter Program.

In the capital markets, during the fiscal year we repaid \$705 million of maturing collateral trust bonds and issued \$700 million of new collateral trust bonds. In addition, we repaid \$200 million of maturing dealer medium-term notes and issued \$800 million of new dealer medium-term notes.

Subsequent to our May 31, 2018 fiscal year end, on July 12, 2018, we redeemed \$300 million of the \$1 billion 10.375% collateral trust bonds due November 1, 2018, thereby reducing the maturity tower of this bond to \$700 million.

On July 15, 2018, we repriced one of our notes payable under the Guaranteed Underwriter Program. On July 26, 2018, we issued a new three-year \$300 million floating rate dealer medium-term note at a spread of three-month LIBOR plus 37.5 basis points. This was an opportunistic issuance driven primarily by a reverse inquiry. In addition, in July 2018, we amended our \$300 million revolving note purchase agreement with Farmer Mac to extend the final maturity date from July 31, 2018, to December 20,

2023. The facility contains an auto-renew provision beginning January 31, 2019, and thereafter on the 20th of each June and December until the final maturity date.

For future 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 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. As also 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, long-term credit fundamentals.

The mainstay of CFC's financial strength is in the quality of our portfolio. The credit quality and performance statistics of our loan portfolio continue to remain strong. 99% of our loans are to rural electric systems that have limited rate regulation and are geographically disbursed across the United States; and 93% of our loans are on a senior secured basis, with collateral being utility assets and our members' revenue.

We have not had any delinquent or nonperforming loans or charge-offs in our electric utility portfolio during the last five consecutive fiscal years.

Overall, CFC has a long history of low non-performing loans in our electric portfolio. In addition, because of our senior secured position, we have had a very high average recovery rate in the event of default. At May 31, 2018, our allowance for loan losses, which is an estimate of probable losses inherent in our loan portfolio, was only 0.07%, or 7 basis points of our loan portfolio.

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- and medium-term investments, as well as long-term capital. We view these investments to have limited reinvestment risk, thus providing a stable and reliable funding source for CFC. Our member investments stood at \$4.4 billion at May 31, 2018, representing 18% of our total 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. Our members' equity has grown by 50% to \$1.5 billion from \$998 million since 2013.

CFC will continue to utilize different funding vehicles that we have established over the years. For short-term funding, our plan is to maintain our dealer 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, namely 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 May 31, 2018, CFC had \$3.1 billion committed revolving credit facilities from our relationship banks, \$1.2 billion committed availability in the Guaranteed

Underwriter Program, and the \$2.6 billion revolving credit capacity via the Farmer Mac secured note purchase agreements.

In addition to these liquidity sources that CFC has had over the years, during the fiscal year 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 May 31, 2018, we had \$520 million of held-to-maturity investment securities.

These sources, together with cash, other investments, and scheduled loan amortization and other repayments from our members, resulted in CFC having \$9.2 billion of liquidity available at May 31, 2018, to meet the next 12 months of all of the debt maturities of \$6.6 billion, a 1.4 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 2.5 times.

Thank you once again for joining us today to review our results for our fiscal year ended May 31, 2018. 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 your questions via the web service so that we may respond to those as well. Thank you.

- Operator: Thank you. The question-and-answer session will be conducted electronically. If you would like to ask a question, please press star followed by the digit one. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, star-one if you would like to ask a question. And we'll pause for a moment.
- Andrew Don: Okay, operator. It seems like we don't have any that were submitted electronically, and it doesn't sound like we have any on any of the lines.
- Operator: There are no questions, correct.
- Andrew Don: Okay, great. Thank you very much for joining us. Have a good day.
- Operator: And that will conclude today's call. We thank you for your participation.