National Rural Utilities Cooperative Finance Corporation

Alaska Electric Utility Accounting and Finance Workshop

Financial Ratios and Equity, Capital Credits, Forecast/Cash Flows

October 8, 2015

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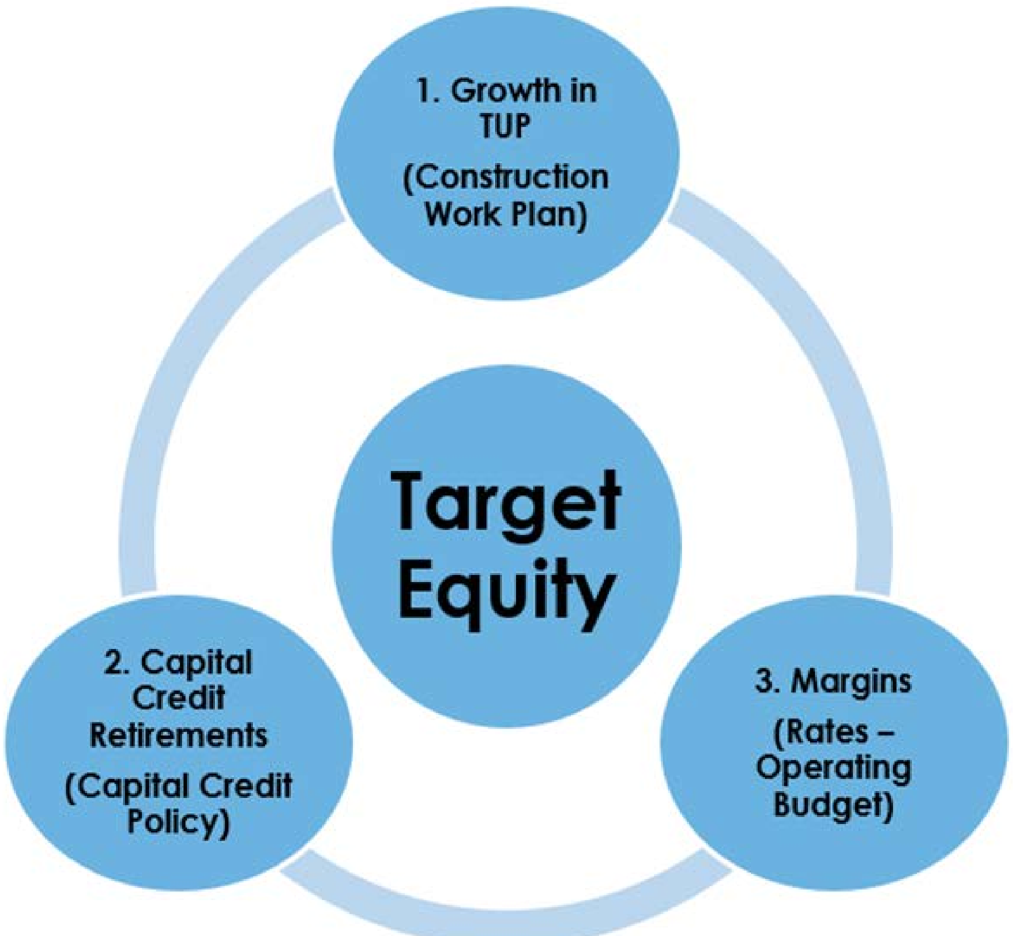
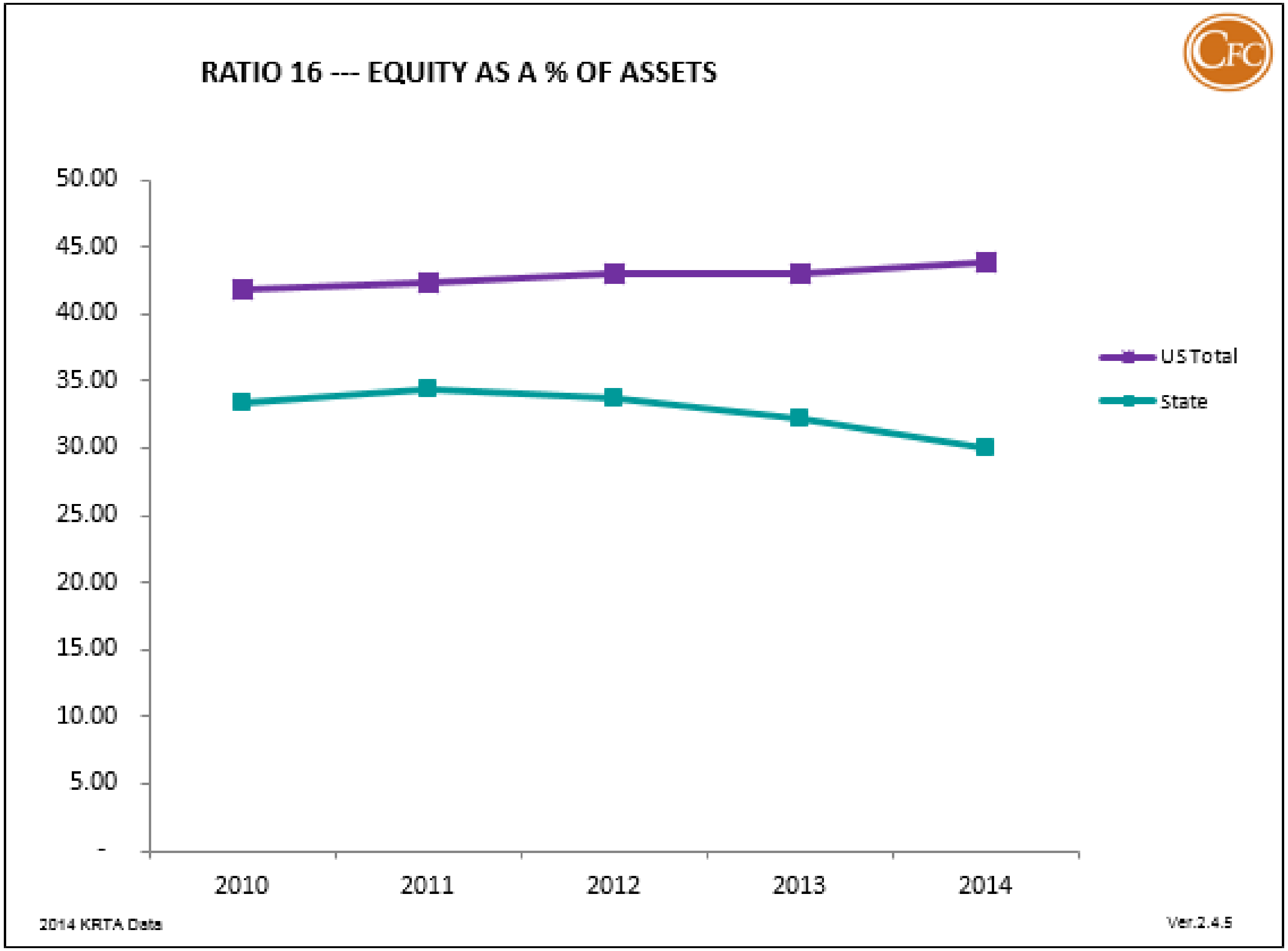
Equity Management



Determining the "Right" Equity Level

- **Dual goals**
- **Raise capital at the lowest cost to the members**
- **While**
- **Maintaining an adequate level to mitigate business risk and take advantage of business opportunities**
- **Where do you start?**
  - Benchmarks

14% Lower



KRTA Analysis Toolpak, Version 2.4.5

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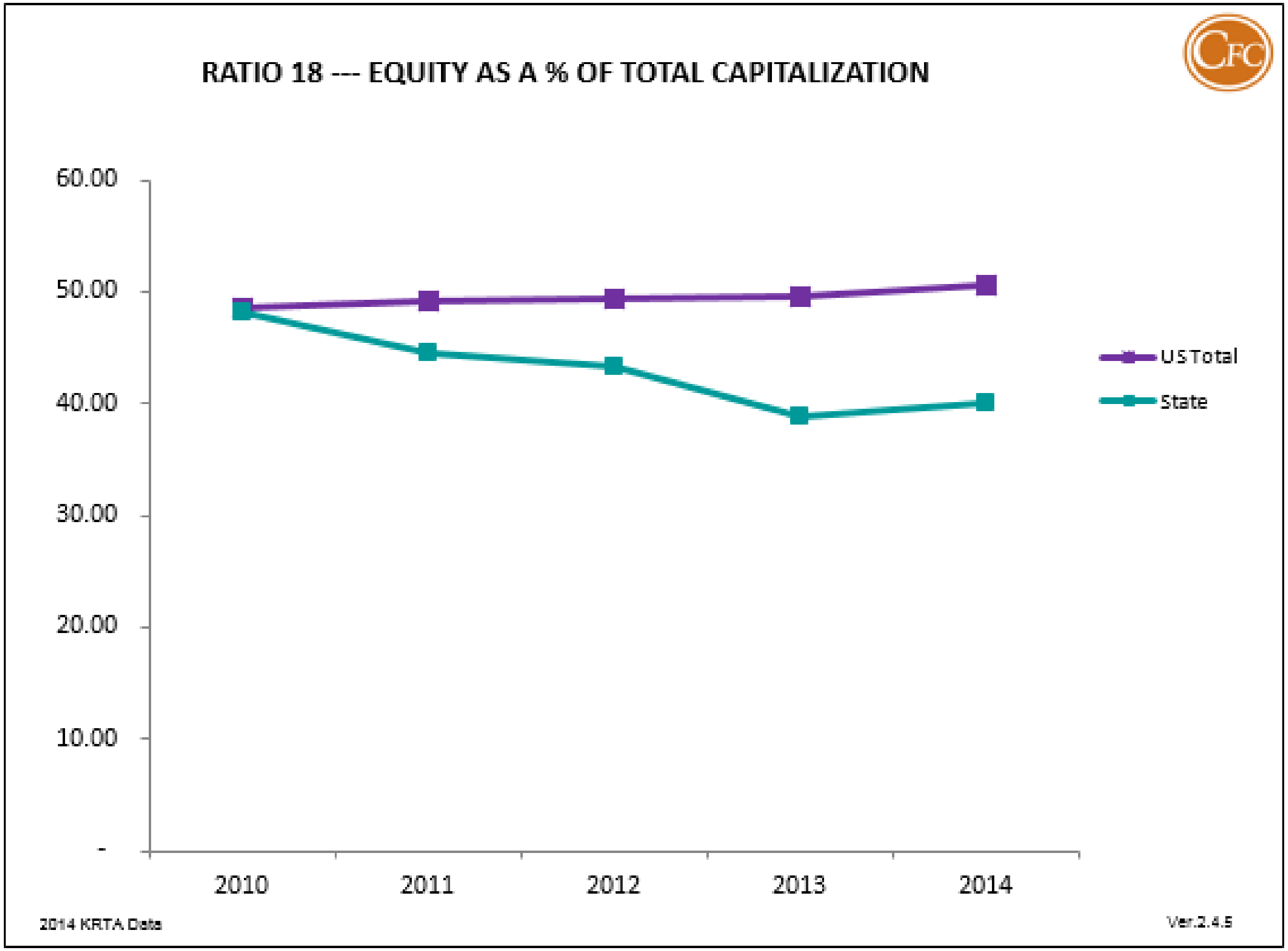
Much Closer



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Capital Credits

- **Legal issues**
  - Not retiring
  - Net present value
    - Common business practice
  - Past members
    - Interesting
  - More then a reasonable amount of equity
    - 501 (c) (12) – only maintain a reasonable amount
  - State enabling/cooperative act
    - Alaska - "A cooperative shall be operated on a nonprofit basis for the mutual benefit of its members and patrons. The bylaws of a cooperative or its contracts with members and patrons must contain such provisions relating to the disposition of revenues and receipts as may be necessary and appropriate to establish and maintain its nonprofit and cooperative character".
  - Settlements
    - High discount rate

Cooperative Status IRS 501 (c)(12)

Three requirements

- Subordination of capital
- Democratically controlled
- Operation at cost

- **85/15 test**
  - Must pass annually to be exempt from federal income tax

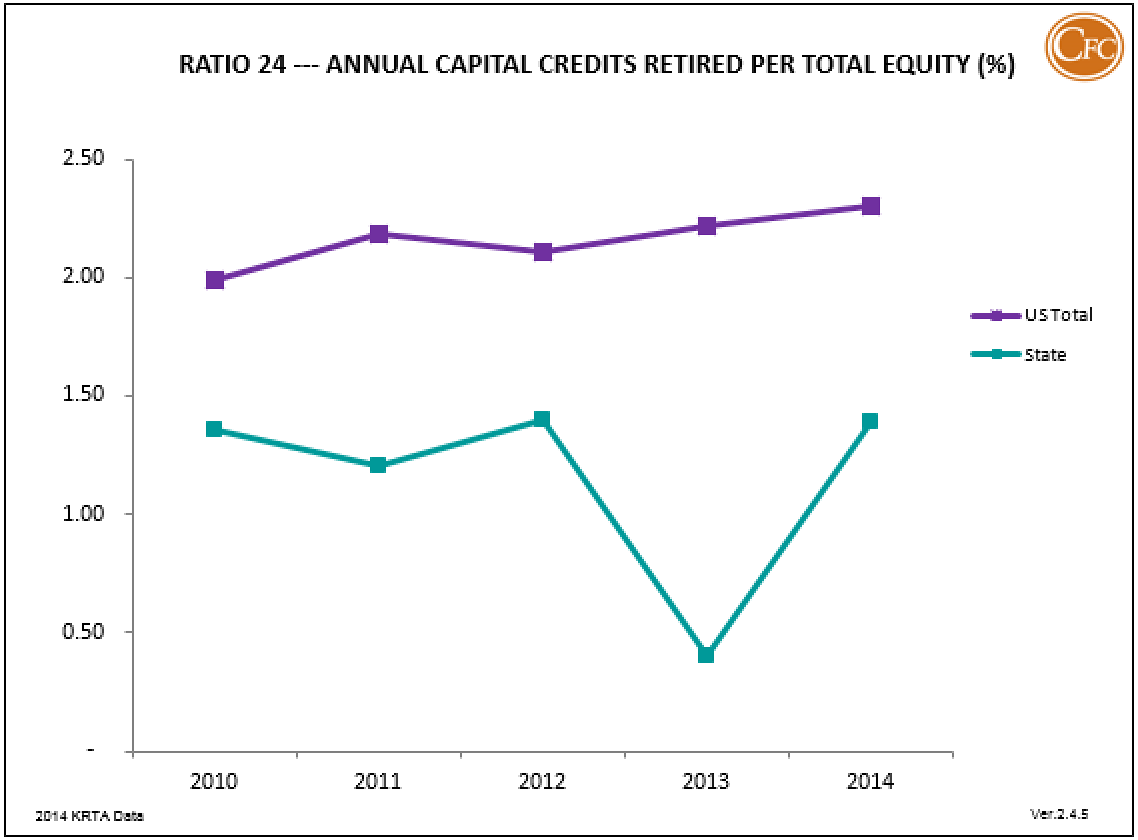
Capital Credit Task Force Report – 12 Recommendations

1. Have a capital credit policy
2. Have an equity management plan
3. Adequate equity level
4. Permanent equity
5. Notify members of allocations
6. Contractual forfeiture
7. Retirement methods based on goals

Capital Credit Task Force Report – 12 Recommendations

8. Discount special not general retirements
9. Discount rate equal weighted average cost of capital
10. Age of members
11. Director flexibility
12. Communications

2014 – 10 Out Of 15



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Forecasting Cash Flows

- **Annual budget**
  - Operating margins plus depreciation
  - Less
    - Capital credit retirement
    - Asset additions – determined by desired equity level
    - Principal payments
  - Increase/decrease in cash
- **Meaningful information for the board**
  - Can demonstrate the need to borrow or adjust rates

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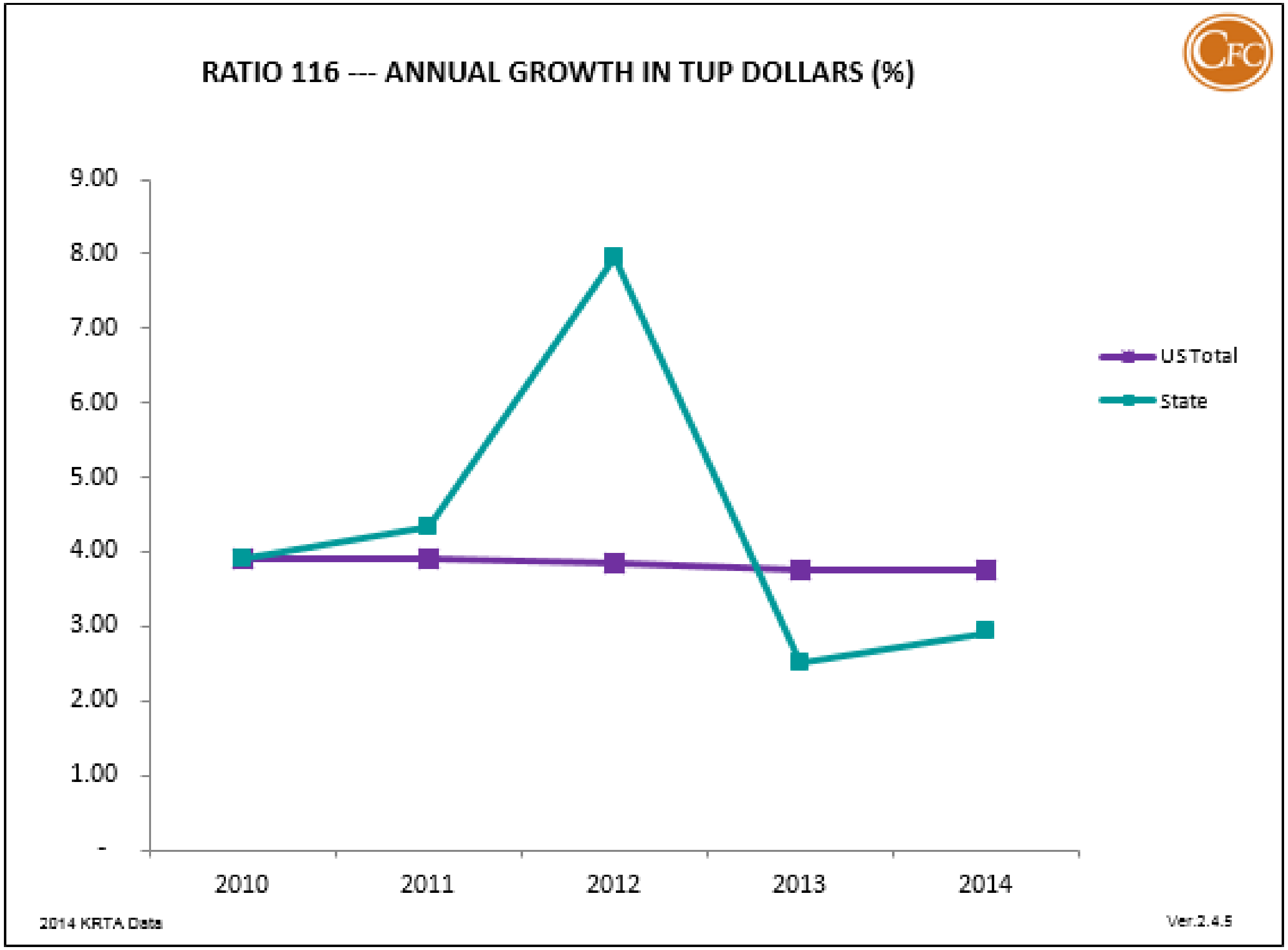
Growth in TUP



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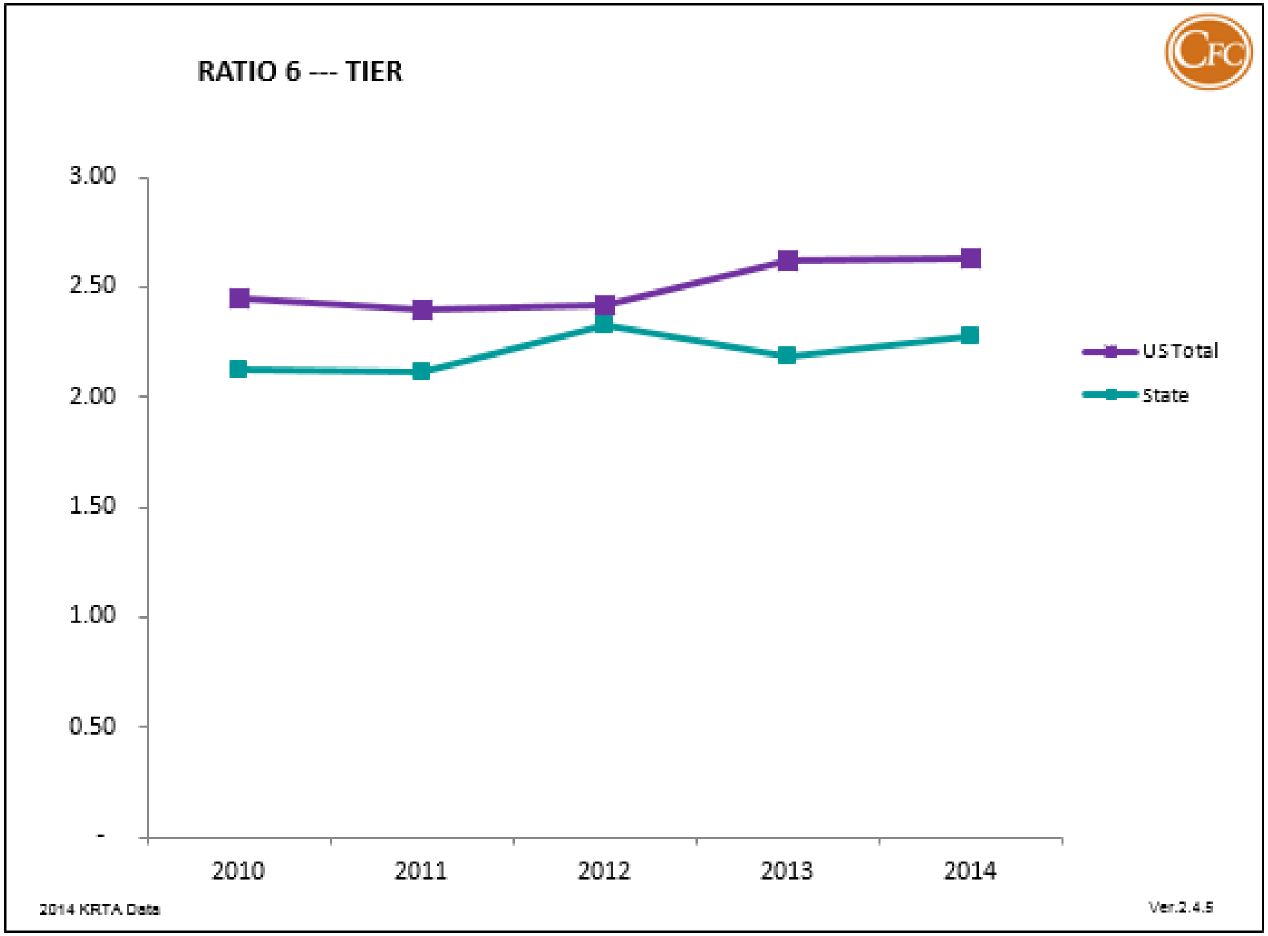
Margin Requirements

- Cash
- Lender
- Equity

- Biggest number wins

- Target an operating ratio that generates the required margin

Margins



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Alaska Median Numbers

- Equity as a percent of capitalization - 2014 40.12%

- Five year averages 2010 - 2014
  - Capital credits retirements % of equity 1.15%
  - Growth in assets 4.33%
  - TIER 2.20
  - Blended interest rate 3.98%

Tying It All Together

Equity Management Model

Current Equity	$18,830,000	Total Current Capitalization	$46,930,000
Current LT Debt	$28,100,000	Equity %	40.12%

Return on Equity Calculation

						Margin Requirement
	Growth Rate	4.33%	Return on Equity	5.48%	Detail	
Step 1	CC Retirement Cycle	0	Return for growth	4.33%		$815,339
	CC Retirement %	1.15%	Return for rotation	1.15%		$216,545
						$1,031,884

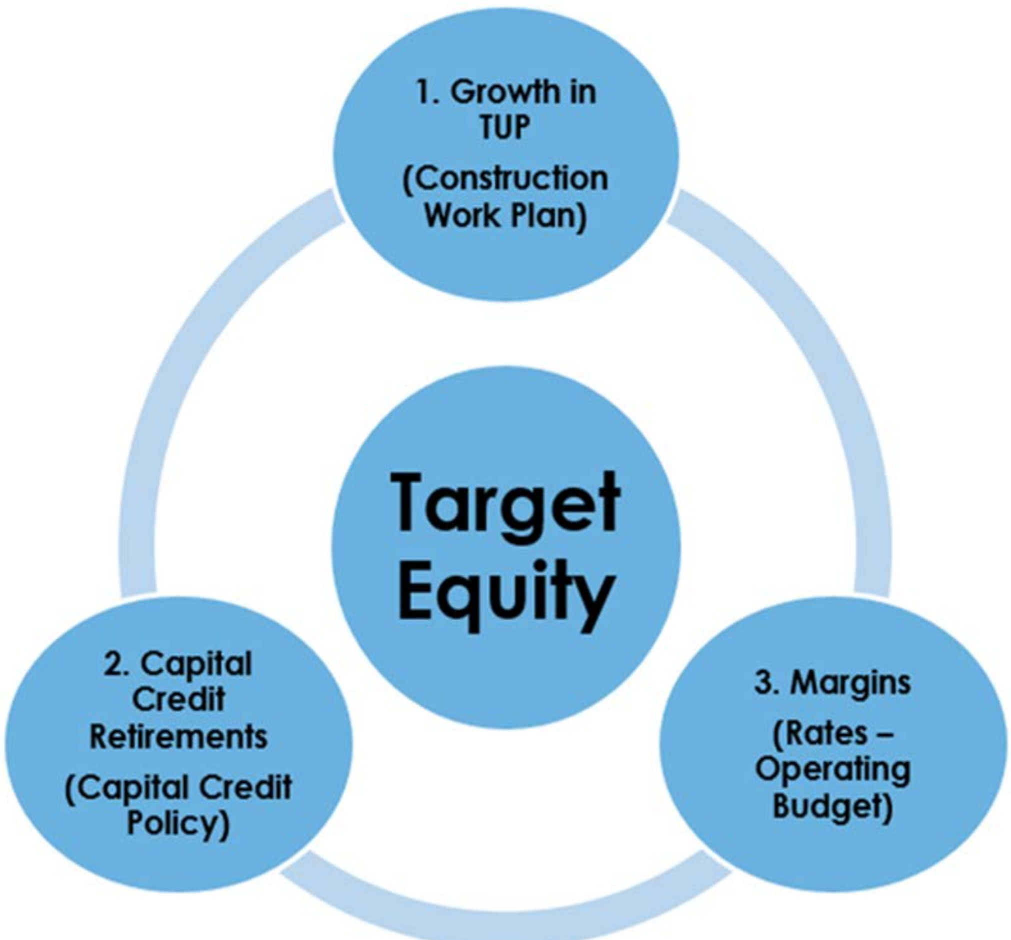
Return on Equity Required to Meet Equity Target Objectives

						Margin Requirement
	Existing Equity	40.12%				
Step 2	Target Equity	0.00%	Return on Equity	0.00%	Detail	
	Years to Make Target	0.00	Return for growth	4.33%		$815,339
			Return for rotation	1.15%		$216,545
			Return for change	0.00%		$0
						$1,031,884

Ultimate Equity Level Calculation

Step 3	Desired TIER	2.20	Calculated Equity	48.55%	Detail
	Blended Interest Rate	4.31%			Graphs

Summary



Questions