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Conference Title: FY2024 Second-Quarter Investor Conference Call

Moderator: Joshua Carter

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Operator: Good afternoon and welcome to the National Rural Utilities Cooperative Finance Corporation Fiscal year 2024, Second Quarter Investor call. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Heesun Choi, vice president capital markets relations. Please go ahead.

Heesun Choi: Thank you, operator. Welcome to our investor conference call for our second quarter of fiscal year 2024. Joining with me today are Andrew Don, our Chief Executive Officer, and Ling Wang, our Chief Financial Officer. Andrew and Ling will discuss our financial and operating resources during the three months and six months ended November 30th, 2023.

Today's presentation, slides and financial reports filed with the SEC are available on our website, www.nrucfc.coop, under investor relations. This call is being recorded and a replay and core transcript will be made available under investor relations.

Our presentation today will include forward-looking statements and certain non-GAAP financial measures. Please review the disclosures on slide two and slide three of the presentation regarding these statements and measures. I would like to remind you that any forward-looking statements that we may make during today's call as of January 23rd, 2024, are subject to risk and uncertainties. Factors that may cause actual results to differ materially from expectations are described on slide two of today's presentation, as well as in our annual and quarterly reports filed with the SEC.

Information about any non-GAAP financial measures referenced during the presentation, including reconciliations to GAAP measures, can also be found in our Form 10-Q filed with the SEC on January 12th, 2024, as well as in the appendix of the presentation slides.

At the end of the presentation, we will open up the call and Andrew and Ling will take your questions. You can ask questions over the phone or submit your questions online. With that, I will turn this call over to Andrew.

Andrew Don: Thank you, Heesun. Good afternoon. Thank you for joining our call today to review the financial and operating results during the six months ended November 30, 2023, which is our second fiscal quarter of our 2024 fiscal year.

I'm moving to slide five to discuss certain operating and financial highlights for the second quarter and the first six months of our fiscal year 2024. Our financial position remains strong as we generated solid results during our first two fiscal quarters. Our loans to members continued to grow and reach $33.6 billion, representing an increase of approximately $1 billion, or 3%, during the six months ended November 30, 2023. Our loan portfolio remains pristine, with no charge-offs during the fiscal year and having only 0.25% of loans classified as non-performing at the end of the reporting period.

Our adjusted TIER was 1.23 times during the six months ended November 30th, 2023, well above our goal of 1.1 times. We remain committed to grow our members' equity to support loan growth. Our members' equity stood at $2.3 billion on November 30, 2023. Our liquidity position remains sound as we maintain diverse, well-established funding sources to minimize the risk of being dependent on any single source or market.

Our diverse liquidity sources consist of cash, time deposits, investments, committed bank lines, committed loan facilities under the guaranteed underwriter program, revolving note purchase agreement with Farmer Mac and access to repo facilities.

We continue to be committed to maintaining strong investment grade credit ratings from Fitch, Moody's and S&P. Our short-term and long-term credit ratings and outlook remain unchanged. Recently, in December 2023, S&P affirmed all the CFC's credit ratings with stable outlook.

Now I'm turning slide six to review highlights of our loan portfolio. As I mentioned, our loans to members reached $33.6 billion on November 30, 2023, compared to $32.5 billion at May 31, 2023, reflecting a $565 million increase during the first fiscal quarter and a $457 million increase during the second fiscal quarter for a total increase of approximately $1 billion.

89%, or $906 million, of the net loan increase was driven by increases in loan store distribution and power supply borrowers. On November 30, 2023, our loans to distribution members totaled $26 billion and our loans to power supply members totaled $5.7 billion, accounting for 94% of total loans to members.

Looking at the increases by member class, our loan distribution portfolio increased by $605 million and our power supply loan portfolio increased by $301 million. We also experienced increases in RTFC loans of $58 million and CFC statewide and associate loans of $68 million and a decrease and CSC loans of $10 million during six months ended November 30, 2023.

In terms of loan type, long-term loans increased by $853 million to $30.3 billion and line of credit loans increased by $169 million to $3.3 billion on November 30, 2023, compared to the levels at our fiscal year end of May 31, 2023.

During six months, we made long-term loan advances in a total amount of $1.6 billion. Approximately $1.5 billion, or 94%, of those advances were for capital expenditure purposes with the remaining balance being for other purposes, primarily business acquisitions. Additionally, of the $1.6 billion total long-term loans advanced, $1.5 billion were fixed-rate loan advances with a weighted average fixed-rate term of 12 years.

In comparison, the fixed-rate term was 18 years for long-dated loans advanced during the same period from our prior fiscal year. Some of our members have shown a preference for slightly shorter fixed-rate term loans given the prevailing higher interest rate environment.

We estimate that there were over 200 electric cooperatives engaged in rural broadband projects at various stages of development. Generally speaking, these projects are financed through a mix of grants and debt funding.

On November 30, 2023, CFC's total outstanding loans associated with these broadband loans was approximately $2.7 billion, an increase of $369 million compared to May 31, 2023, level of $2.4 billion.

With that, I would like to now turn the call over to Ling, who will review our financial results in greater detail. Thank you.

Ling Wang: Thank you, Andrew, and good afternoon, everyone. I am going to turn to slide eight to discuss our financial results for the six-month ended November 30, 2023.

Our total assets at the fiscal quarter ended November 30, 2023, were approximately $35.5 billion, an increase of $1.5 billion, or 4%, from the prior fiscal year-end level. The primary driver of this growth was a $1 billion increase in loans to members along with $400 million in short-term time deposits that we established during the quarter. We plan to use these time deposits to pay down a portion of our maturing long-term debt in February of 2024.

Our total liabilities increased by $1.2 billion, or 4%, to $32.6 billion on November 30, 2023, as we issued debt to fund asset growth. Our members' equity, which excludes cumulative derivative forward value gains and accumulated other comprehensive income, increased by $64 million to $2.3 billion from the prior fiscal year-end, primarily due to the adjusted net income of $136 million during the first six months of this fiscal year, partially offset by the CFC Board of Directors authorized patronage capital retirement in July 2023 of $72 million.

Our adjusted debt-to-equity ratio was at 6.38-to-1 and November 30, 2023, an increase from 6.04-to-1 at May 31, 2023. There are several factors driving this increase. First, we had to issue more debt to fund the growth in our loan portfolio. Second, in June 2023, we redeemed early $100 million of our $400 million subordinated deferral debts due 2043 when the coupon reset to a variable rate. Third, an estimation earlier, we returned $72 million in patronage capital to our members during this fiscal year.

We expect that our adjusted debt-to-equity ratio will remain above our target of 6-to-1, due to the projected increase in total debt outstanding to fund anticipated loan growth and the early retirement of patronage capital as part of our RTFC consolidation with NCSC.

As discussed on the previous calls, we have been working on consolidating RTFC and NCSC business operations. In connection with the consolidation process, we made an early redemption of $12 million of members subordinated certificate at par in October 2023. We finalized the consolidation on December 1st, 2023. And subsequent to the closing of the consolidation, we returned $51 million in patronage capital to RTFC members in January of 2024.

Looking at slide nine for our loan portfolio. The composition of our loan portfolio remained largely unchanged from the prior fiscal year-end. Specifically, our loan portfolio consists mainly of long-term fixed-rate secure loans to rural electric cooperatives.

In November 30, 2023, $33 billion, or 98%, of our loans consist of loans to rural electric systems and $546 million, or 2%, to the telecommunication sector. Our long-term fixed-rate loans were 88% of total loans outstanding on November 30, 2023, similar to the level of 87% at May 31, 2023. Our long-term loans are typically secure by substantially all assets of the borrowers. And we typically lend to our members on a senior secured basis, with 92% of our loans being senior secured on November 30, 2023, unchanged from the May 31, 2023, level.

We generally offer long-term amortized loans to our members for up to 35 years. The average remaining maturity of our long-term loans, which accounted for 90% of total loans outstanding on November 30, 2023, was 19 years.

The history of our loan portfolio performance is presented on slide 10. The quality of our loan portfolio continued to demonstrate strength and we observed positive trends in our credit metrics. We had only one non-performing loan outstanding on November 30, 2023, totaling $85 million, or 0.25% of total loans outstanding. This loan was made to an electric power supply borrower.

In comparison, we had two CFC electric power supply borrowers, totaling $89 million, classified as non-performing at May 31, 2023. During the first quarter of this fiscal year, we received $4 million in loan principal payment from one of the non-performing borrowers.

Our allowance for credit losses increased by $3 million to $56 million at November 30, 2023, compared to $53 million at May 31, 2023. The allowance coverage ratio increased to 17 basis points at November 30, 2023, from 16 basis points at May 31, 2023.

The $3 million increase in the allowance for credit losses reflected a $4 million increase in the collective allowance due to the growth in the loan portfolio and a slight decline in the overall credit quality and risk profile of our loan portfolio, partially offset by a $1 million reduction in the asset specific allowance. During the six months ended November 30, 2023, we had no loan charge-offs. We had an annualized net recovery rate of 1 basis point during this period from the prior non-performing loans.

We believe that the overall credit quality of our loan portfolio remains strong at November 30, 2023, evidenced by the limited defaults and losses in our electric utility portfolio since the inception of CFC. Specifically, in our 54-year history, we have experienced only 18 defaults in our electric utility portfolio. Of the 18 defaults, one is in the process of being resolved, nine resulted in no loss and eight resulted in a cumulative net charge-offs of merely $100 million.

Moving on to slide 11. During the second quarter, our adjusted net income increased by $22 million, or 46%, primarily due to a $10 million increase in adjusted net interest income, a $11 million reduction in the provision for credit losses, a $2 million favorable shift from losses to gains recorded in our investment securities and a $3 million increase in fees and other income, partially offset by a $4 million increase in operating and other non-interest expenses.

For the six-month period, our adjusted net income increased by $31 million, or 29%, primarily due to a $16 million increase in adjusted net interest income, a $14 million reduction in the provision for credit losses, a $9 million favorable shift from losses to gains recorded on our investment securities and a $3 million increase in fees and other income, partially offset by an $11 million increase in operating and other non-interest expenses.

The $10 million increase in adjusted net interest income during the second quarter and the $16 million increase in adjusted net interest income for the six-months period were driven by a 7%

increase in our average interest earning assets and increases in the adjusted net interest yield of 7 basis points and 3 basis points for the second quarter and for the six-month period, respectively.

Specifically, our adjusted net interest yield was 1.12% for the current second quarter, compared to 1.05% for the same prior-year quarter, and our adjusted net interest yield was 1.11% for the six-month period, compared to 1.08% for the same prior-year period.

Being a member-owned finance cooperative association, our primary financial goal focuses on earning an annual minimum adjusted time interested ratio, or TIER, of 1.1 times. For the quarter ended November 30, 2023, our adjusted TIER increased by 0.04 to 1.24 times, compared to the same prior-year quarter. And for the six-month period, our adjusted TIER remained at the same level at 1.23 times, compared to the same prior-year period. Those are well above our target of 1.1 times.

Our total debt outstanding was $32.2 billion at November 30, 2023, an increase of $1.2 billion, or 4%, from the prior fiscal year-end level, primarily to fund the growth in our loan portfolio. We continue to maintain diverse funding sources, including funding from our members as well as capital markets and non-capital markets funding.

At November 30, 2023, $5.2 billion of CFCs funding came from our members in the form of short-term and long-term investment, an increase of $320 million, or 7%, from the May 31, 2023, level. Our member investments represented 16% of our total debt outstanding on November 30, 2023, unchanged from May 31, 2023.

At November 30, 2023, our funding under the guaranteed underwriter program and notes payable with Farmer Mac totaled $11 billion, a $926 million or 9% increase from May 31, 2023, primarily due to net increases of $752 million in borrowings under the Farmer Mac note purchase program and $174 million under the guaranteed underwriter program. The guaranteed underwriter program and Farmer Mac note purchase agreement program represented 33% of our total debt outstanding at quarter end.

Our capital markets related funding sources totaled $16 billion at November 30, 2023, a $50 million, or less than 1%, decrease from May 31, 2023. The decrease was primarily due to a net decrease of $254 million in dealer commercial paper outstanding, a net decrease of $99 million in subordinated deferral debt and a net decrease of $396 million in collateral trust bonds, offset by a net increase of $699 million in dealer medium-term notes.

Dealer commercial paper outstanding stood at $1 billion at November 30, 2023, and was within our quarter-end target range of $1 to $1.5 billion. At November 30, 2023, capital markets related founding sources accounted for 51% of our total funding, compared to 52% at May 31, 2023.

At November 30, 2023, 56% of our total debt was secured and 44% was unsecured, unchanged from the May 31, 2023, levels. Our short-term borrowings increased by $616 million to $5.2 billion, accounting for 16% of our total debt outstanding at November 30, 2023, compared to $4.5 billion, or 15%, of total debt outstanding at May 31, 2023.

The increase in short-term borrowings was driven primarily by a $370 million increase in short-term member investments and a $500 million short-term borrowing from Farmer Mac, partially offset by a $254 million decrease in outstanding dealer commercial paper.

A total of $3.6 billion, or 70%, of our short-term borrowings came from our member short-term investment at November 30, 2023, compared to $3.3 billion, or 72%, at May 31, 2023. As we have consistently stated, the investment from our members are a very reliable funding source with little reinvestment risk as our members continue to invest a large portion of their excess funds with us. Our member short-term investments have averaged $3.6 billion over the last 12 fiscal quarter-end reporting periods.

Slide 13 shows the various sources of liquidity that CFC had in place at November 30, 2023. Our available liquidity from various sources included cash, time deposits, investments, committed bank lines, committed loan facilities under the guaranteed underwriter program and Farmer Mac revolving note purchase agreements totaling $6.6 billion at November 30, 2023.

Our total liquidity amount does not include the $1.5 billion scheduled repayment and amortization on long-term loans we expect to receive from our members over the next 12 months.

As an update for the committed bank lines, we have two revolving credit facilities with a syndicate of banks. During the quarter, we amended these credit facilities and extended the maturity dates by one year to November 2026 and November 2027. We also increased the commitment amount by $100 million for each credit facility, totaling $200 million at closing.

As indicated in the table on the right side, at November 30, 2023, we had a total of $7.4 billion in debt maturities over the next 12 months, with 49%, or $3.6 billion, of these debt maturities representing short-term investments from our members. Because our members have traditionally rolled over a large portion of their short-term investment with us at maturity, we consider our member investments to be a very stable and reliable source of funding for CFC.

The remaining $3.8 billion in debt maturities consisted of $1 billion dealer commercial paper, $500 million short-term notes payable to Farmer Mac and $2.2 billion long-term and subordinated debt obligations. At November 30, 2023, excluding debt maturities related to our member short-term investments, we had a total liquidity buffer of $2.8 billion, equivalent to 1.7 times over our 12-month debt maturities.

In addition, subsequent to the quarter end in December 2023, we closed an additional $450 million committed loan facility under the guaranteed underwriter program, resulting in an increase of the total availability under the guaranteed underwriter program from $750 million, as of November 30, 2023, to $1.2 billion.

Slide 14 summarizes CFC's projected long-term debt issuance needs over the next 18 months, subsequent to November 30, 2023. Our cash needs are derived from two primary areas, refinancing existing debt maturities and funding loan advances to our members, partially offset by the amortization and repayment of loans from our members, and our funding needs also are driven by our member investment levels.

Over the next 18 months, from December 2023 through May 2025, we have a total of $4.7 billion of long-term debt maturities and amortization consisting of $3.2 billion in capital markets debt and $1.5 billion in non-capital markets debt.

We expect our loan growth over the same period to be approximately $2.5 billion. As indicated in the chart, we project issuing approximately $5.4 billion in long-term debt over this time period to refinance existing debt and to fund the expected loan growth.

Thank you once again for joining us today to review our results for our current second fiscal quarter ended November 30, 2023. We appreciate your interest in CFC and look forward to discussing our financial performance and funding plans in the future.

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

Operator: And if you would like to ask a question over the telephone, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach your equipment. Once again, that is star one if you would like to ask a question over the telephone and we'll pause for just a moment. And there are no telephone questions at this time, but again that is star one if you would like to signal.

Ling Wang: Okay. It doesn't look like we have any questions on the phone or online. Once again, thank you for joining the call today. Please feel free to contact us if you have any questions and would like to follow up. We look forward to speaking with you in the future. Thank you.

Operator: Once again, that does conclude is conclude and we thank you all for your participation. You may now disconnect.