National Rural Utilities Cooperative Finance Corporation
FY21 Second-Quarter Investor Call
January 20, 2021
10:00 AM EDT

Operator: Good day, everyone, and welcome to the Second-Quarter 2021 Investor Call. Today's program is being recorded. At this time, I'd like to turn the conference over to Ling Wang. Please go ahead, ma'am.

Ling Wang: Good morning. This is Ling Wang, Vice President of Capital Markets at National Rural Utilities Cooperative Finance Corporation. Welcome to our fiscal year 2021 second-quarter investor call. Joining our call this morning is Andrew Don, our Chief Financial Officer.

Before we begin, let me remind you that some of the information provided and the comments made during today's call may include forward-looking statements that 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 other 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 forward-looking statements about our current expectations are included in our 10-K and 10-Q filed with the SEC. All the forward-looking statements are made as of today, January 20, 2021, 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 remarks will also include certain non-GAAP measures. Please refer to our Form 10-Q filed on January 12, 2021 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 have a Q&A section 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 our webcast. We encourage you to take this opportunity to ask any questions you may have. In addition, all the material for this event including presentation slides and financial reports are available on our Investor Relations section of our website at www.nrucfc.coop. A replay and 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 second quarter and for the first six months of fiscal year 2021 for the period ended November 30, 2020.

Our total assets at November 30, 2020 were approximately $28.2 billion, a slight decrease of $87 million from the prior fiscal quarter-end, but similar to the May 31, 2020 level. Our loans to members increased by $134 million during the current quarter, and $361 million during the first six months ended November 30, 2020. During the current quarter, the increase in loans to members was driven by increases in long-term and lineofcredit loans of $107 million and $27 million, respectively. However, for the first six months, the increase in loans to members was primarily driven by an increase in long-term loans of $492 million, partially offset by a decrease in line-of-credit loans of $132 million. During the first six months, we experienced increases in CFC distribution loans, NCSC loans, and RTFC loans of $453 million, $7 million, and $46 million, respectively; and decreases in CFC power supply loans and CFC statewide associate loans of $135 million and $11 million, respectively.

For the six months ended November 30, 2020, CFC's long-term loan advances totaled nearly $1.3 billion, consisting of $1.1 billion or 85% for capital expenditure purposes, and $69 million or 5% to refinance other lenders' debt. In comparison, during the same prior-year period, long-term loan advances totaled nearly $1.4 billion with $963 million or 69% for capital expenditure purposes, and $345 million or 25% for the refinancing of other lenders' debt.

Our members' equity, which excludes cumulative derivative forward value losses and accumulated other comprehensive loss, increased by $50 million from the prior quarter, which was driven by an adjusted net income of $49 million for the current quarter. Our members' equity increased by $43 million from our prior fiscal year-end of May 31, 2020, as a result of an adjusted net income of $107 million for the six-month period, partially offset by CFC's Board of Directors' authorization in the first quarter to retire patronage capital of $60 million.

Our adjusted debt-to-equity ratio was at 5.90 to 1 at November 30, 2020, a decrease from 5.96 to 1 at August 31, 2020, but an increase from 5.85 to 1 at May 31, 2020. The increase from the prior fiscal year-end level was primarily attributable to a reduction in adjusted equity, which was due to the maturity and redemption of our members' subordinated certificates and the authorized patronage capital retirement, partially offset by the adjusted net income for the period. That said, our adjusted debt-to-equity ratio remained below our targeted threshold of 6 to 1.

For the current quarter ended November 30, 2020, CFC generated an adjusted net income of $49 million and an adjusted TIER of 1.24 times compared with an adjusted net income of $44 million and an adjusted TIER of 1.2 times for the same prior-year quarter. The $5 million increase in adjusted net income in the current quarter from the same prior-year quarter was largely attributable to an increase in the adjusted net interest income of $7 million or 11% to $72 million for the current quarter, partially offset by the unfavorable shift in the provision for credit losses of $3 million from the benefit recorded in the same prior-year period. The $7 million or 11% increase in adjusted net interest income during the current quarter was driven by an increase in the adjusted net yield of 9 basis points or 9% to 1.05%, and an increase in average interest-earning assets of $575 million or 2%. The increase in the adjusted net interest yield reflected the favorable impact of a reduction in our adjusted average cost of funds of 34 basis points to 3.16%, partially offset by a decrease in the average yield on interest-earning assets of 25 basis points to 4.01%. The overall lower interest rate environment contributed to the decreases in both our average funding cost and our average asset yield.

For the six months ended November 30, 2020, CFC generated adjusted net income of $107 million and an adjusted TIER of 1.26 times compared with adjusted net income of $105 million and adjusted TIER of 1.23 times for the same prior-year period. The $2 million increase in adjusted net income for the six-month period from the comparable prior-year period was due to an increase in adjusted net interest income of $14 million or 11% to $145 million, a decrease in general and administrative expenses of $5 million due to reduced travel expenses and event costs, partially offset by the absence of a gain of $8 million from the sale of land and a reduction in prepayment fee income of $5 million, both recorded in the prior-year period, and an unfavorable shift in the provision for credit losses of $3 million from a benefit recorded in the same prior-year period. The $14 million or 11% increase in adjusted net interest income during the current six-month period was driven by an increase in the adjusted net interest yield of 7 basis points or 7% to 1.04%, and an increase in average interest-earning assets of $762 million or 3%. The increase in adjusted net interest yield reflected the favorable impact of a reduction in our adjusted average cost of funds of 36 basis points to 3.16%, partially offset by a decrease in the average yield on interest-earning assets of 28 basis points to 4%.

We continue to actively monitor the COVID-19 pandemic impact on our borrowers' financial conditions and analyze key credit metrics of our borrowers to facilitate the timely identification of loans with potential credit weaknesses and any notable shifts in the quality of our loan portfolio. We currently believe the pandemic has not had a significant negative impact on CFC's financial condition and operating results, as well as our members' financial conditions. Assuming no material adverse change to the overall credit quality of our borrowers, we expect that our financial performance for fiscal year 2021 will be comparable or slightly better than our financial performance for fiscal year 2020, excluding the one-time impairment charges we had during the fourth quarter of fiscal year 2020. In particular, our prior fiscal year results included two one-time non-cash charges consisting of a $31 million software project impairment charge, and a $34 million loan impairment charge.

The overall composition of our loan portfolio at quarter-end November 30, 2020 remained similar from the composition at the prior fiscal year-end of May 31, 2020, with $26.6 billion or 98% of our portfolio consisting of loans to rural electric systems, and $431 million or 2% to the telecommunications sector. In comparison, at May 31, 2020, loans to rural electric systems totaled $26.3 billion, representing 99% of our portfolio. Loans to the telecommunication sector was $385 million or 1% of our portfolio. The percentage of CFC's long-term fixed-rate loans was at 93% as of November 30, 2020, similar to the 92% level at the May 31, 2020 year-end. We typically lend to our members on a senior secured basis, with 94% of our loans being senior secured at both November 30, 2020, and May 31, 2020.

We did not have any loan delinquencies, loan defaults, or charge-offs during the six month ended November 30, 2020, and during the last three fiscal years. In addition, we have not had any loan defaults in our electric utility loan portfolio since fiscal year 2013.

As of November 30, 2020, we had one nonperforming loan in our portfolio totaling $153 million. We classified this loan to a CFC power supply borrower as nonperforming during the fourth quarter of fiscal year 2020, given the special circumstances discussed during prior investor calls. This borrower is not in default and was current with respect to required payments on the loan as of November 30, 2020.

Our allowance for credit losses increased to $59 million as of November 30, 2020, from $53 million, as of May 31, 2020, largely due to the $4 million additional allowance for credit losses recorded with the adoption of CECL on June 1, 2020. Our allowance coverage ratio was at 22 basis points at November 30, 2020, compared to 20 basis points at May 31, 2020. 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 now have a sustained period of 30 consecutive fiscal quarters for which we have had no credit losses in our electric utility portfolio.

Our total debt outstanding was $26 billion as of November 30, 2020, a very nominal increase of $17 million from May 31, 2020, as we used the cash that we had on hand as of May 31, 2020 to fund the majority of our cash needs through November 30, 2020. CFC continues to maintain diverse funding sources to minimize the risk of being dependent on any single source or market. As of November 30, 2020, $5.4 billion of CFC's funding came from our members in the form of short-term and long-term investments, similar to the May 31, 2020 level. Our member investments represented 21% of our total debt outstanding at both November 30 and May 31, 2020. Over the last 12 quarters, our member investments have averaged approximately $4.9 billion at each quarter-end. At November 30, 2020, our funding under the Guaranteed Underwriter Program and notes payable with Farmer Mac totaled $9.1 billion or 35% of our total debt outstanding, a decrease of $232 million from May 31, 2020 due to a note maturity and regularly scheduled principal amortization.

Our capital markets related funding sources totaled $11.5 billion at November 30, 2020, an increase of $264 million from the prior fiscal year-end. During the six-month period, our dealer commercial paper outstanding increased by $715 million, as we did not have any dealer commercial paper outstanding at our prior fiscal year-end of May 31, 2020. In addition, we closed a $400 million Sustainability Collateral Trust Bond transaction in October 2020. These increases were partially offset by a $755 million Collateral Trust Bond and $104 million InterNotes maturities during the same period.

At November 30, 2020, capital markets related funding sources accounted for 44% of our total funding, compared to 43% at the prior fiscal year-end. At November 30, 2020, 61% of our total debt was secured and 39% was unsecured, compared with 64% secured and 36% unsecured at May 31, 2020. Our short-term borrowings totaled $4.7 billion and accounted for 18% of our total debt outstanding at November 30, 2020, compared with $4 billion or 15% of total debt outstanding at May 31, 2020. The majority or 82% of our short-term borrowings came from member investments at November 30, 2020, compared with 94% at the prior fiscal year-end. As we have consistently stated, the investment from our members is a very reliable funding source with little reinvestment risk, as our members consistently invest a large portion of their excess funds with CFC.

This slide presents CFC's long-term debt maturities and amortization for the calendar year 2021 which is very manageable. So we do not have any large debt maturity concentrations. Our primary debt maturities during this period include two dealer medium-term note maturities totaling $750 million, and several Farmer Mac note maturities totaling $390 million. We believe we have ample sources of liquidity to meet each of the maturities, as will be highlighted on the next slide.

This slide depicts the various non-capital market sources of liquidity that CFC had in place at November 30, 2020, compared with the prior fiscal year-end. Our availability under the Guaranteed Underwriter Program increased by $375 million from the prior fiscal year-end. In November 2020, we closed an additional $375 million committed loan facility with the Federal Financing Bank under the Guaranteed Underwriter Program, which allows us to borrow anytime before July 15, 2025 for up to 30 years at a very attractive spread.

As indicated in the graph, we had an aggregate of approximately $6.4 billion of member and non-member debt maturities over the next 12 months as of November 30, 2020, compared with $6 billion as of May 31, 2020. At November 30, 2020, we had access to $8.7 billion of liquidity, which is 1.3 times the combined member and non-member debt maturities or $2.2 billion greater than the combined member and non-member debt maturities. Approximately 62% or $4 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 source of funding for CFC. If we excluded the $4 billion debt maturities related to our member short-term investments, we would have total liquidity equal to 3.6 times or $6.2 billion of liquidity in excess of dealer commercial paper and the current portion of non-member long-term debt maturities during the next 12 months, subsequent to November 30, 2020.

This slide presents CFC's projected long-term debt issuance needs over the next 18 months subsequent to November 30, 2020. 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 from our members. We expect approximately $1 billion of net loan growth over the next 18 months, with nearly half of this amount occurring during our third fiscal quarter of 2021, which is the period of December 1, 2020, to February 28, 2021. During the month of December 2020, we experienced strong loan demand from our members. More specifically, during December our outstanding loans to members increased by an additional $476 million, driven by increases in long-term and line-of-credit loans of $274 million and $202 million, respectively.

As indicated in the last column, our expected long-term debt issuances over this time period are approximately $4.2 billion, largely to refinance existing long-term debt maturities. For the remainder of the fiscal year ending May 31, 2021, our projected long-term debt issuances are approximately $1.3 billion. Also note that the other sources and uses of cash column in the middle of the slide reflects net increases or decreases to our dealer commercial paper outstanding, short-term member investments, and investment portfolio. For future potential funding needs, we 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 strong and stable. During our second fiscal quarter, all three credit rating agencies reaffirmed CFC's ratings and outlook and published updated ratings reports on CFC. CFC has a long-term incentive compensation plan which is tied to our credit ratings. Specifically, we must maintain an A/A2 issuer credit ratings with a stable outlook in order to receive a payout under our long-term incentive plan. Our primary corporate goal is to maintain strong long-term credit fundamentals for our members and investors.

The overall quality of our loan portfolios continues to be strong with 98% of our loans to rural electric systems and 94% of our loans being on a senior secured basis. We have not had any loan defaults in our electric utility loan portfolio since fiscal year 2013. We had no charge-offs during the six months ended November 30, 2020, and during the last three fiscal years. The coverage ratio of our allowance for credit losses remained low at 22 basis points of our total loan portfolio at November 30, 2020. In CFC's 51-year history, throughout various economic cycles, we have experienced very limited charge-offs, loan defaults, loan delinquencies, and nonperforming loans in our electric portfolio. While there continues to be uncertainty about the duration and severity of the COVID-19 pandemic and the extent of its future economic impact, our borrowers operate in an industry sector that historically has been resilient to economic downturns. Our electric utility cooperative members thus far have been able to manage the challenges and pressures presented by the pandemic. As a result, through today's date, we have not experienced any delinquencies in scheduled loan payments from our borrowers and we have not received any requests from our borrowers for payment deferrals.

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 continued to grow and stood at $5.4 billion at November 30, 2020, representing 21% of our total funding, compared with $4.2 billion or 18% at our fiscal year-end 2016. As a member-owned cooperative organization, CFC cannot issue common or preferred equity. However, we are committed to grow our equity through retained earnings. Our members' equity has grown by 35% to $1.8 billion from $1.3 billion since our fiscal year-end of 2016.

We continue to maintain diversified funding sources and demonstrate a strong liquidity profile. Our funding sources are very well-established and have remained stable. From a liquidity perspective at November 30, 2020, we had $719 million of cash, cash equivalents, and short-to-intermediate-term liquid fixed income investment securities, $2.7 billion committed revolving credit facilities from our relationship banks, $1.3 billion committed availability in the Guaranteed Underwriter Program, and $2.6 billion revolving credit capacity via the Farmer Mac secured note purchase agreements. These sources, together with scheduled loan amortization and other repayments from our members, resulted in CFC having $8.7 billion of liquidity available at November 30, 2020, to meet the $6.4 billion of debt maturities over the next 12 months, a 1.3 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 3.6 times.

Thank you once again for joining us today to review our results for the first six months ended November 30, 2020. 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 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. And if you'd like to ask a question, 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 our equipment. Again, that is star, one, to ask a question. And we'll pause for just a moment to allow everyone an opportunity to signal for questions.

And there are currently no questions over the phones.

Andrew Don: Okay. Thank you, operator. And thank you all who have joined us today, and we look forward to talking with you in the future about our funding, as well as operational results. Have a good day.

Operator: Thank you. And again, that does conclude today's call. You may now disconnect.