State of Utah
Department of Commerce
Division of Public Utilities

FRANCINE GIANI
Executive Director

THAD LEVAR
Deputy Director

PHILIP J. POWLICK
Director, Division of Public Utilities

JON HUNTSMAN Jr.
Governor

GARY HERBERT
Lieutenant Governor

MEMORANDUM

To: Utah Public Service Commission

From: Division of Public Utilities

Philip J. Powlick, Director
Artie Powell, Manager, Energy Section
Charles Peterson, Technical Consultant
Marlin Barrow, Technical Consultant
Inna Lyon, Intern

Subject: Application of Dixie-Escalante Rural Electric Association, Inc. for Authority to Issue Securities in the form of a Secured Promissory, a Revolving Line of Credit Agreement and Related Documents. Docket No. 08-066-01.

Date: May 27, 2008

ISSUE

Dixie-Escalante Rural Electric Association, Inc. (Dixie-Escalante, or the Company) requests Authority to Issue Securities in the form of a Secured Promissory, a Revolving Line of Credit Agreement and Related Documents pursuant to the requirements of UCA 54-4-31(2). The Secured Promissory Note (or Loan) is in the amount of approximately $20,000,000. The Line of Credit Agreement will increase the Company's current credit line from $2,000,000 to $5,000,000. The Commission issued an action request to the Division of Public Utilities (Division, or DPU) with a due date of May 26, 2008. Since May 26, 2008 was the Memorial Day holiday, the Division is submitting its analysis today, May 27, 2008.

RECOMMENDATION (Approval)

The Division recommends that the Commission authorize Dixie-Escalante to issue securities in the form of a Promissory Note for $20,000,000 and to increase the Company's line of credit from $2,000,000 to $5,000,000.

DISCUSSION

Information used in the Division's analysis included Annual Reports of Dixie-Escalante Rural Electric Association, Inc. for years ending December 31, 2003 through 2007; attachments filed by the Company with the Application which included the Company's Board resolutions approving the increase in the credit line to $5,000,000 and the loan agreement for $20,000,000 dated February 8, 2008; a copy of the Secured Promissory Note including appendices for $20,000,000 dated March 17, 2008; a copy of the Revolving Line of Credit Agreement also dated March 17, 2008. These credit facilities will be backed by a mortgage on virtually all of the Company's property.[1] Both the Promissory Note and the Credit Agreement are with the National Rural Utilities Cooperative Finance Corporation (CFC). At the Division's request the Company also provided a detailed analysis and forecast of the Company's needs through 2017.

<u>Historical Results</u>

Exhibit 1 sets forth the audited consolidated historical financial results from 2003 to 2007 for the income statement and balance sheet.

The income statement shows revenues on average increased by 13.35 percent annually from about $11.6 million in 2003 to $19.1 million in 2007. Operating expenses had grown from $10.5 million in 2003 to over $18.1 million in 2007, which results in a 14.58 percent rate of growth. Interest expense grew from $230 thousand to $456 thousand over 2003 to 2007. Net income has

[1] Application, paragraph 9, page 5.

been generally flat over the period considered, fluctuating from about $1.3 million in 2003 down to $988 thousand in 2005, then up to $1.4 million in 2007.

The balance sheet information shows that the Cash and Equivalents also fluctuated rising from $216 thousand in 2003 to $2.2 million in 2005 and then down to $382 thousand in 2007. However, total current assets increased from $2.2 million in 2003 to nearly $9.0 million in 2007 driven primarily by sharp increases in materials and supplies. Net plant and equipment increased steadily from $26.5 million in 2003 to 36.9 million in 2007, an 8.65 percent average annual increase. Total assets increased at an average annual rate of 12.91 percent from $31.4 million in 2003 to almost $51.0 million by 2007.

Current liabilities increased at over 18 percent annually as all major subcategories expanded rapidly. However the growth in current assets, especially materials and supplies was funded primarily by long-term capital rather than current liabilities since the Company's current ratio (current assets divided by current liabilities) expanded from 0.92 in 2003 to 1.90 in 2007. Long-term debt over the 2003 to 2007 period was relatively flat. Members' Equity added about $2.2 million growing from $12.4 million in 2003 to about $15.6 million in 2007. The major source of funding for the increase in assets discussed above came from Customer Advances for Construction and Deferred Revenue in the form of Impact Fees which are the major components of the "Other Deferred Credits" line item. Other Deferred Credits more than doubled from $8.2 million in 2003 to $21.9 million by 2007 for a 27.74 percent average annual increase.

Page 5 of Exhibit 1 set forth financial ratios for the years ended December 31, 2003 through 2007. As mentioned above, the Company's current ratio has more than doubled from .92 in 2003 to 1.90 on 2007. The quick ratio has fluctuated widely over the time period from .56 in 2003 to 1.24 in 2005, and then back to .42 in 2007. The quick ratio traces primarily the fluctuations in Cash and Equivalents described above. Long-term solvency ratios have deteriorated somewhat over the 2003 to 2007 period. The 2007 figures were all below their 2003 to 2007 averages. Further and significant deterioration in these ratios, especially the times interest earned ratio would not be good and could hamper further debt financing should more financing be necessary. At this point the times interest earned ratio is still a decent 3.55. Asset utilization ratios, especially Revenues to Fixed Assets and Revenues to Total Assets have been fairly stable and have even improved slightly in 2007. Profitability ratios have generally declined over the period as income remained more-or-less flat while revenues and plant increased. Dixie-Escalante's capital structure remained fairly stable throughout the period at a reasonably healthy 63 percent members' capital to 37 percent debt.

The above brief historical analysis indicates that Dixie-Escalante has been able to meet its obligations. Long-term liquidity measures and profitability measures have shown some deterioration over the period. This would cause more concern were the Company not able to raise funds from its Members as need arises.

Forecast and Loans 2007 to 2017

The Company prepared a forecast which detailed the expected transmission expansion from, St.George, Utah to Littlefield, Arizona. According to the Company, the proposed 30-mile 138 kV transmission line is necessary to meet growth in the area. The cost of the transmission line is projected to be $7.1 million and is expected to meet load growth for about the next 30 years.[2] The remainder of the new financing is expected to be primarily used for a new substation in the Washington Fields area of Washington County, Utah. The cost of the new substation is estimated at $21 million and, according to the Company, is necessary to service the continued growth in the area. The Application notes especially the Sand Mountain subdivision which is projected to contain over 2,000 building lots.[3] The increased line of credit will be used to provide working capital for both of these projects as well as the other needs of the Company. The Company included forecast rate increases to customers and growing revenues due to growth and expansion. As one might expect, the forecast shows that the Company will be able to meet its long-term obligations including increased financing costs in the future. The Company's forecast has its times interest earned ratio (TIER) declining from the historical level of about 3.5 to 1.5.

[2] Ibid, paragraph 3, page 3.
[3] Ibid., paragraph 4, page 3.

Normally this would be a cause for concern if the Company were not able to raise rates or equity capital to meet its needs. However, being an association, presumably the Company can raise rates as needed. However, if a prolonged economic slump were to occur, it would likely stretch Company's finances.

The Division has not attempted to evaluate the reasonableness of the terms and conditions of financial transaction. The Division relied upon the Company's own analysis and the analysis of the lender CFC. The Division based its recommendation for approval on the following factors.

A. The Company, which has total access to financial information about its operations and budgets has conducted an evaluation and concluded that this is the most beneficial option available.

B. The Company represents that the Board of Directors has approved the proposed transaction at its February 8, 2008.

C. In its Application, Dixie-Escalante represents that the Loan and Line of Credit are in the best interests of Dixie-Escalante and its ratepayers; that the Company has sufficient operating margins to service the additional debt; that the proposed funds are to be used for lawful purposes, compatible with the public interest; are necessary or consistent with the proper operations of the Company; and will note impair the Company's ability to perform its services as a public utility.[4]

D. The Company has the ability to raise customer charges, if necessary, in order to meet its financial obligations.

[4] Ibid., paragraphs 12-14, pages 5 and 6.

E. Attached as Exhibit 1, in 5 pages, are financial statements of the Company for the years 2003 through 2007. These financial statements are supplied to the Division on an annual basis. The Division has not performed a detailed financial analysis of the Company. However, based upon these financial statements it appears the Dixie-Escalante has been financially stable for the last five years and has been able to meet its financial obligations.

Based upon these considerations, the Division recommends that the Commission approve the Application of Dixie-Escalante Rural Electric Association, Inc. for Authority to Issue Securities, Docket No. 08-066-01.

cc: LaDell Laub, Asst. General Manager, Dixie-Escalante Rural Electric Association, Inc.

Gary Dodge, Attorney for Dixie-Escalante Rural Electric Association, Inc.

Michelle Beck, Committee of Consumer Services

Cheryl Murray, Committee of Consumer Services