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State of Utah
Department of Commerce
Division of Public Utilities

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Director, Division of Public Utilities

MEMORANDUM

To: Utah Public Service Commission

From: Utah Division of Public Utilities
Chris Parker, Director
Artie Powell, Energy Section Manager
Bob Davis, Utility Analyst
Charles Peterson, Technical Consultant

Date: May 18, 2015

Re: PacifiCorp Dividend Declaration with Intended Payment on June 4, 2015

RECOMMENDATION (NO ACTION)

Based upon the following analysis, the Division finds no indication that the capital and operations of PacifiCorp will be impaired pursuant to UCA 54-4-27. Therefore the Division recommends that the Commission take no action.

ISSUE

In a letter dated May 4, 2015, PacifiCorp (Company) announced that its board of directors had declared a dividend amounting to $250 million payable June 4, 2015 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp last paid a dividend on March 12, 2015 that amounted to $450 million.

Discussion

The Division of Public Utilities (Division) has investigated the effects of the dividend on the capital and cash flows of the Company using the latest financial information available, the

annual financial statements through December 31, 2014 financial filings. The Division has also reviewed the Company's bond rating through the various bond rating agencies.

In approaching this assignment, the Division understands the terms "impaired" and "impairment" in the statute to mean that (1) the payment of the dividend will result in actions being taken against the Company by creditors, rating agencies, or others due to a reduction in the value of the capital, or the violation of loan covenants, or other agreements; (2) the payment of the dividend would result in a reduced ability of the Company to provide service through a lack of working capital or other financial capacity to continue its operations in the same manner it would if the dividend were not paid.

Exhibit 1 sets forth financial results for the fiscal years ended December 31, 2009 through 2014.

Revenues have grown at an annual rate of 3.34 percent, from about $4.46 billion in 2009 to $5.25 billion in 2014. The Company's actual energy costs have been growing at a slightly faster rate than revenues between 2009 and 2014 where they have increased at a 3.55 percent annual rate. Total operating expenses grew 3.07 percent annually over 2009 to 2014.

Earnings from operations grew from approximately $1.06 billion to $1.30 billion over the 2009 to 2014 time period; the average annual growth rate for that period is 4.17 percent. From 2009 to 2014, interest expense has been essentially flat at around $350 million per year. The Company's net income has grown from $550 million in 2009 to $698 million in 2014, for a 4.88 percent growth rate. The three month March 31, 2015 results show that net income declined by $21 million to $134 million from the March 31, 2015 period amount of $155 million. Revenues for the first three months of 2015 also declined from the year-earlier period from $1.29 billion to $1.25 billion. This result suggests that the Company's 2015 annual revenues may approximate $5.10 billion versus $5.25 billion in 2014, and net income may decline to around $600 million compared to $698 million net income for all of 2014. Total results for 2015 may not reflect an extrapolation of the results for the first three months of the year.

PacifiCorp initiated dividend payments in 2011 with total dividends amounting to $550 million; in 2012, 2013, and 2014 the Company paid $200, $500, and $725 million, respectively. Prior to 2011, the Company last paid a dividend in March 2006. Going forward, there is an expectation that the Company will continue to pay dividends to its parent. However, the Division believes that additional dividend payments in 2015 are unlikely. After 2015, the Division believes that annual dividend payments will be essentially flat at about $700 million for several years.

The balance sheet information on pages 3 and 4 of Exhibit 1 indicates that the cash and equivalent balances have fluctuated widely between $23 million as of December 31, 2014 and $117 million as of December 31, 2009. As of March 31, 2015 the cash balance has dropped further to only $12 million. While the Division understands that the Company has substantial lines of credit it can draw on for operational liquidity, this is the lowest level of liquidity the Company has reported on its balance sheet in recent memory. Total current assets amounted to $1.57 billion in 2009, but have been fairly stable averaging about $1.5 billion since then, before a decline to about $1.36 billion as of March 31, 2015. Current liabilities balances have fluctuated over the 2009 to 2014 time period, but overall have been relatively flat. In 2009 the current liabilities balance was $1.01 billion; in 2011 the balance was $1.81 billion. Current liabilities amounted to $1.12 billion as of December 31, 2014 before rising to about $1.36 on March 31, 2015 largely due to the addition of $190 million in short-term debt.

Net plant and equipment grew from $15.54 billion to $18.72 billion over the 2009 to 2014 period; on March 31, 2015 the balance had risen to about $18.78 billion. Other assets have trended upward over the 2009 to 2014 time period, increasing from $1.86 billion to $2.02 billion. Total assets grew at a 3.26 percent annual rate over the 2009 to 2014 time period, ending at almost $22.27 billion at the end of 2014. As of March 31, 2015, total assets declined slightly from the balance of the previous December to $22.17 billion, primarily due to the decline in current assets discussed above.

Long-term debt (excluding the current portion) has also grown steadily from $6.40 billion in 2009 to nearly $6.92 billion in 2014; long-term debt was approximately $6.87 billion as of March 31, 2015. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $2.62 billion in 2009 to almost $4.61 billion in 2014. As of March 31, 2015, the deferred income tax balance stood at $4.62 billion. Common equity increased from $6.69 billion in 2009 to $7.75 billion in 2014. The growth in common equity was facilitated by equity contributions from Berkshire Hathaway Energy (BHE) totaling almost $1.1 billion since the 2006 acquisition, by the growth in net income, and by the lack of dividend payments between March 2006 and February 2011. With the resumption of significant annual dividend payments (i.e. in excess of $500 million annually), the Division expects common equity balances to grow relatively slowly going forward. The March 31, 2015 balance of common equity amounted to about $7.44 billion which reflects the payment of a $450 million common dividend versus $134 million in net income during the first three months of the year.

The financial ratios on page 7 of 7 of Exhibit 1 show that while there have been year-to-year variations, most of the short-term and long-term liquidity ratios have been basically flat. From a bond-rating perspective, one of the crucial measurements, times-interest-earned, made a five year low in 2011 and 2012 at 3.09 times, but rebounded in 2013 to 3.80 and 3.84 in 2014. Its 2009-2014 average is 3.38. For the three-month interim period ended March 31, 2015, this measure was calculated at 3.24. A similar measurement adds back depreciation to the earnings in the times-interest-earned ratio and may approximate rating agencies' Funds From Operations (FFO) measure. This measurement is also set forth on page 7 of Exhibit 1 and follows a similar path as the times-interest-earned ratio. It ranges from 4.71 times in 2009 to 5.90 times in 2014; with a five year average of 5.15.

All of the profitability ratios had been trending downward from 2009 to 2012 before rebounding in 2013 and 2014. For the three-months ended March 31, 2015, these interim period ratios softened from the year-end 2014 due to the lower profitability described earlier. The level of return on equity has consistently been one or more percentage points below the Company's

authorized returns. The nearly constant annual rate increases among the states in its service territory and the Company's ability to implement energy balancing account programs in most of its states may be the primary contributing factors to this apparent recovery in profitability from the recent lows in 2012. It remains to be seen whether the trend of the first three months in 2015 continues for the full year, in which case return on equity may approach 7.0 percent versus the Company's authorized return (on regulatory rate base) of 9.80 percent in Utah.

Asset utilization ratios have generally declined suggesting that in recent years the Company has not been doing as well as in the past in generating revenues (and profits) from its expanding asset base. Whether this is due to the Company's current build cycle, or some systemic negative in the Company or both is not clear from the data.

Standard & Poor's, in its March 31, 2014 report on PacifiCorp, rated PacifiCorp's business risk "Excellent" and its outlook "Stable." However, Standard & Poor's rates the Company's financial risk profile "significant" based the capital expenditure and dividend needs resulting in negative discretionary cash flows requiring external financing.

The Company's bond ratings for its senior secured debt (the large majority of the debt) is a Standard & Poor's "A" rating; and a "corporate" rating of "A-". Moody's in its May 7, 2014 opinion rated PacifiCorp A3 (similar to Standard & Poor's A-). It should be noted that these ratings are in part based upon the benefit of the Company's relationship as a subsidiary of BHE and, ultimately, Berkshire Hathaway.

As indicated on Exhibit 1 page 5, PacifiCorp, from 2009 to 2011, has been incurring capital expenditures at a rate of at least $1.51 billion annually. Capital expenditures declined to 1.35 billion in 2012; then declined to under $1.1 billion in 2013 and 2014. The Company's forecast capital expenditures for 2015-2017 have declined significantly in its 2014 SEC Form 10K versus the comparable forecast in the 2013 10K. In the 2013 10K, the Company projected that annual capital expenditures for 2014-2016 would average about $1.03 billion; specifically for 2015 and

2016 capital expenditures were projected to average 1.0 billion each year. Now in the 2014 10K, the projected capital expenditures for 2015-2016 decline by 13.1 percent to average $869 million; 2017 capital expenditures are projected to be $789 million. This apparent reduced need to invest in plant and equipment might free up funds for higher dividend payments to the Company's parent.

The Company's capital expenditure program has required that the Company obtain funding from the debt markets as well as the receipt of equity contributions from BHE. However, beginning in 2011 the Company resumed dividend payments which have likely ended further capital contributions from BHE. The Company in its most recent Integrated Resource Plan cycles has indicated that it believes long-term load growth will be noticeably lower than the Company was previously expecting. If the new IRP-based expectation is realized, then the Company's building program will be reduced for the next decade or more, because additional generation resources will not be needed as quickly.

Exhibit 2 sets forth a forecast of PacifiCorp's financial statements based upon assumptions made by the Division that seem reasonable in light of historical results, the expectation of lower load growth and generation needs and current economic conditions. The economic assumptions that are made in the forecast include a benign inflationary environment for the period of the forecast, continued relatively low interest rates, moderate growth in revenues and net income and improved profitability. Based upon these assumptions, it appears that there should be no significant effect on the Company's financial health due to the payment of the currently announced dividend. It appears that the Company can maintain a program of dividend payments while improving the levels of profitability. The equity portion of the capital structure is expected to decline about 2 percentage points from the current 51.3 percent to around 49.5 percent over the next few years.

Conclusion

The Company has grown significantly over the past few years and has made some improvements in its balance sheet. On the negative side, profitability as measured by returns on equity and total capital has not shown sustained improvement. Indeed, as highlighted above, profitability was on a downward trend before reversing in 2013-2014. However, the results for the first quarter 2015 were not supportive of the apparent improving trend that began in 2013. Nevertheless, the Company does appear, at this time, to be able to make the proposed dividend payment and probably continue a regular dividend payment program without impairing its operations.

cc: Bob Lively, PacifiCorp
Michele Beck, Office of Consumer Services