ACTION REQUEST RESPONSE

TO: Public Service Commission

FROM: Division of Public Utilities:
Chris Parker, Director
Artie Powell, Energy Manager
Douglas Wheelwright, Technical Consultant
Jeffrey S. Einfeldt, Utility Analyst

DATE: January 23, 2018

RE: Docket No. 18-027-01, Application of Flowell Electric Association, Inc. for approval to issue securities in the form of a Secured Promissory Note to National Rural Utilities Cooperative Finance Corporation (CFC) in the amount of $1,000,000.

RECOMMENDATION (Approve)

The Division recommends that the Commission approve the request from Flowell to extend and increase the commitment with CFC as requested.

ISSUE

Flowell Electric Association, Inc. (Flowell, or the Company) requests authorization to issue securities in the form of a revolving credit promissory note to COBANK, ACB ("CoBank") up to $1,000,000. Advances from the Credit Agreement will be used for working capital cash needs as well as for any other permitted corporate purpose of Flowell. The promissory note requested in this application will augment an existing credit line of $1,000,000 Flowell currently has with the National Rural Utilities Cooperative Finance Corporation ("CFC").

Flowell anticipates undertaking material upgrades to existing electric distribution and sub-transmission facilities within its service area. Flowell anticipates these projects will likely be financed largely through separate long-term financing arrangements, but is seeking to increase its available working capital to ensure against any unforeseen short-term liquidity needs in light of these near-term capital projects. Flowell believes the additional revolving promissory note with CoBank will add certainty and stability to its financial position.

DISCUSSION

Information used in the Division's analysis included:

1. Electric Cooperative Annual Reports filed with FERC for Flowell Electric Association, Inc. for years ending December 31, 2012 through December 31, 2016.
2. Audited financial statement of Flowell as of December 31, 2016.
3. CoBank proposed Loan Agreement, Promissory Note and Security Agreement.

Flowell Electric Association is a non-profit, cooperative organized in 1943. Effective January 1, 1999, the seven employees, with the exception of the manager, became employees of Dixie Escalante Rural Electric Association (Dixie). In addition to the employees, all of the inventory and other general assets were transferred to Dixie. Under the agreement between the two companies, Dixie provides Flowell with customer billing statements and plant maintenance services. Flowell provides a shop and yard facilities for Dixie equipment and inventory and is paid an annual fee to maintain relationships with the various communities. This arrangement allows the two companies to share resources and provides Flowell with access to engineering and other resources that were not available internally. This arrangement has worked well for the two companies and has been structured this way due to their mutual relationships with Deseret Generation and Transmission.

The Company has signed agreements to purchase power from Western Area Power Administration. Monthly power needs in excess of this allocation are purchased from Deseret Generation and Transmission (DGT). Flowell is one of six member/owners of DGT, which owns and operates the Bonanza power plant in eastern Utah. Additional power beyond that provided by these two sources is purchased under a contract with the Intermountain Power Project (IPP). The contract with IPP provides that power not needed or used by the association will be allocated to the City of Los Angeles, but is made available to the Association as needed.

Historical Results

Exhibit 1 is a summary of the financial information for 2012 through 2016. The income statement shows an average annual increase in total revenue of 2.32% from $2.378 million in 2012 to $2.607 million in 2016. The increase in revenue was due to higher sales revenue and increased volumes to irrigation customers. Flowell's service area is primarily rural with approximately 84% of the total kWh sales to irrigation customers. Due to the concentration in irrigation, the majority of the revenue is earned during the summer months and is subject to weather related fluctuations. The total number of customers increased slightly from 459 to 503 for the periods under review.

Operating expenses grew from $2.029 million to $2.244 million for an average annual growth of 2.56%. The cost of purchased power as a percentage of total sales fluctuated from a high of 47.9% in 2015 to a low of 40.5% in 2014 with an average of 45.0% per year. Net margins have remained positive for all years under review but have experienced dramatic swings. Year-end 2013 showed modest net margin of $8,000 while 2012, 2014, 2015 and 2016 showed margins of $267,000, $459,000, $328,000 and $295,000. The Company has been very responsive to increasing rates as needed and has received favorable support from its members.

The balance sheet information shows an increase in cash from $31,000 in 2012 to $415,000 in 2016. Net Plant and Equipment increased from $3.449 million in 2012 to $3.975 million in 2016.

Total liabilities increased from $1.728 million to $2.326 million (an average annual increase of 7.7%). Patron's capital increased from $1.895 million in 2012 to $2.869 million in 2016 (an average annual increase of 10.93%. The Company's regulatory capital structure shows common equity of 62.96% and debt of 37.04% as of year-end 2016.

The ratio analysis for year end 2016 shows a current ratio[1] of 1.8 and a quick ratio[2] of 0.75, which is a marked improvement over prior years. The interest coverage ratio (Times Interest Earned[3]) is calculated at 4.53 for 2016 compared to the average of 3.96 for the years under review. Return on Total Capital[4] is calculated at 7.79% compared to the historical average of 8.66%.

Loan covenants in the new agreement have not changed and require a minimum Debt Coverage Ratio[5] of 1.35. As of 2016, the Debt Coverage ratio is calculated at 6.61, with the average for all years under review of 5.57. The Company has been in compliance with the loan covenants for all years under review.

The Company has indicated that the Board of Directors has approved the proposed transaction and provided a certificate of resolution.

---

[1] Current ratio is current assets divided by current liabilities. It is a measure of a company's ability to satisfy its cash needs over the coming twelve months.

[2] Quick ratio is cash plus accounts receivable divided by current liabilities. It is a more stringent measure of a company's ability to satisfy its cash needs over the coming twelve months.

[3] Times Interest Earned is calculated as the earnings before tax divided by the interest expense.

[4] Return on Total Capital is calculated as net margin plus interest expense divided by long term debt plus deferred revenue plus patron's capital.

[5] Debt Coverage Ratio is calculated as earnings before interest and depreciation dividing by interest expense and current maturities of long term debt.

CONCLUSION

Based upon these financial statements, it appears that Flowell has been financially stable for the last five years and has been able to meet its financial obligations. The Division recommends that the Commission approve the Application of Flowell Electric Association, Inc. for Authority to Issue Securities to CoBank for the $1,000,000 requested.

cc: Durand Robison, General Manger, Flowell Electric Association, Inc.
Michele Beck, Office of Consumer Services