State of Utah
Department of Commerce
Division of Public Utilities

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MEMORANDUM

To: Utah Public Service Commission

From: Utah Division of Public Utilities
Chris Parker, Director
Artie Powell, Energy Section Manager
Douglas Wheelwright, Technical Consultant
Charles Peterson, Technical Consultant

Date: February 27, 2015

Re: PacifiCorp Dividend Declaration with Intended Payment on March 12, 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 February 10, 2015, PacifiCorp (Company) announced that its board of directors had declared a dividend amounting to $450 million payable March 12, 2015 to its sole common shareholder, PPW Holdings LLC, a wholly owned subsidiary of Berkshire Hathaway Energy (BHE). PacifiCorp last paid a dividend on September 4, 2014 that amounted to $100 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, 2013 and its interim September 30, 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, 2008 through 2013; and the partial year ended September 30, 2014.

Revenues have grown at an annual rate of 2.73 percent, from about $4.50 billion in 2008 to $5.15 billion in 2013. The Company's actual energy costs have been relatively flat over the period, actually decreasing slightly between 2008 and 2013. Total operating expenses grew at an annual rate of 1.84 percent annually over 2008 to 2013.

Earnings from operations grew from approximately $954 million to $1.26 billion over the 2008 to 2013 time period; the average annual growth rate for that period is 5.79 percent. From 2008 to 2013, interest expense grew from about $309 million to $350 million, for a 2.52 percent growth rate. The Company's net income has grown from $465 million in 2008 to $682 million in 2013, for a 7.96 percent growth rate. The nine month September 30, 2014 results show that net income increased by $35 million to $578 million from the September 2013 period amount of $542 million. Revenues for the first nine months of 2014 increased 3.22 percent over the first nine months of 2013. This result suggests that the Company's 2014 annual revenues may approximate $5.32 billion in revenues versus $5.15 billion in 2013, and net income may top $700 million compared to $682 million net income for 2013. Total results for 2014 may not reflect an extrapolation of the results of the first nine months of 2014.

PacifiCorp initiated dividend payments in 2011 with total dividends amounting to $550 million; in 2012 and 2013 the Company paid $200 and $500 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. The Division believes that additional dividend payments in 2015 are likely. The Division expects that dividends in 2015 will approximate the 2014 sum of $725 million.

The balance sheet information on pages 3 and 4 of Exhibit 1 indicates that the cash and equivalent balances have fluctuated widely between $31 million as of December 31, 2010 and $53 million as of September 30, 2014. The average December 31 balance has been just under $65 million. Total current assets amounted to $1.38 billion in 2008, but have been fairly stable averaging about $1.5 billion since then. Current liabilities balances have fluctuated over the 2008 to 2013 time period, but overall have been relatively flat. In 2008 the current liabilities balance was $1.47 billion; in 2011 the balance was $1.81 billion, but since 2012 and September 30, 2014 the balances were between $1.2 and $1.3 billion.

Net plant and equipment grew from $13.82 billion to $18.51 billion over the 2008 to 2013 period; on September 30, 2014 the balance had risen to about $18.73 billion. Other assets have trended upward over the 2008 to 2012 time period, increasing from $2.0 billion to $2.2 billion, but have dropped noticeably in 2013 and September, 2104 to below $1.7 billion. Total assets grew at a 4.76 percent annual rate over the 2008 to 2013 time period, ending at almost $21.7 billion in 2013. As of September 30, 2014, total assets stood at $21.86 billion.

Long-term debt (excluding the current portion) has also grown steadily from $5.42 billion in 2008 to nearly $6.64 billion in 2013; long-term debt was approximately $6.94 billion as of September 30, 2014. Deferred income taxes, which represent the accumulation of a positive cash flow item, has increased from $2.03 billion in 2008 to almost $4.36 billion in 2013. As of September 30, 2014, the deferred income tax balance stood at $4.45 billion. Common equity increased from $6.03 billion in 2008 to $7.79 billion in 2013. 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 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, with 2013 generally showing some improvement over 2012. 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. Its 2008-2013 average is 3.29. For the nine-month interim period ended September 30, 2014, this measure was calculated at 4.13. 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 4.86 times in 2008 to 4.76 times in 2011; with a five year average of 4.98. Of interest is that in 2013 this FFO-like measure increased to 5.73; the September 30, 2014 value increased further to 6.17 times.

All of the profitability ratios had been trending downward from 2008 to 2012 before rebounding in 2013. For the nine months ended September 30, 2014, these interim period ratios improved from the year-end 2013 values to their highest levels since 2008. The level of return on equity has consistently been one or more percentage points below the Company's authorized returns. However, for the interim September 30, 2014 results, the return on equity was measured at 10.34 percent, which suggests the Company may equal or exceed its authorized rate of return in 2014, at least on an SEC reporting basis. 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.

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. These ratios improved, but only slightly, in 2013.

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 2008 to 2011, has been incurring capital expenditures at a rate of at least $1.5 billion annually. Capital expenditures declined to 1.35 billion in 2012; then declined to under $1.1 billion in 2013. Furthermore, the Company stated in its December 31, 2013 SEC Form 10-K that it expected capital expenditures for 2013, 2014, and 2015 total only $3.4 billion, or less than an average of $1.15 billion per year.[1] This decline in capital expenditures will improve the Company's cash flow before accounting for the Company's financing activities (e.g. debt issuances and retirements and dividend payments). The Company's capital expenditure program has required that the Company obtain funding from the

[1] PacifiCorp 10-K, pages 39-40.

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 cycle has indicated that it believes 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 so, 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.[2] 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 3.5 percentage points from the current 51.9 percent to around 48.3 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 has been on a downward trend for the last five years. However, there are some signs that this decline in profitability may have begun reversing in 2013 and continued improvement through September 2014. The Company does appear, at this time, to be able to make the proposed

[2] This forecast also takes into account the fact that Company has reacquired and retired almost all of its outstanding preferred stock.

dividend payment and probably continue a regular dividend payment program without impairing its operations.

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