State of Utah
Department of Commerce
Division of Public Utilities

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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
Douglas Wheelwright, Utility Analyst

Subject: Docket No. 10-027-01, 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 $2,000,000.

Date: January 29, 2018

RECOMMENDATIONS (Approval)

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 extend and increase the financing commitment from $1.85 million to $2.00 million with National Rural Utilities Cooperative Finance Corporation (CFC). This commitment will be in place for 5 years and will be used to provide a source for long term financing for planned capital work projects. When specific projects are identified, the Company will make a formal request for CFC to issue individual notes under this commitment. Each note is structured with repayment terms appropriate to the project and may have a maturity date and amortization of up to 40 years. Each new advance will reduce the total amount available under this commitment. CFC provides this type of financing in order to simplify the availability of long term loans to fund anticipated future capital improvements. As of the date of this analysis, no specific projects have been identified. This commitment and the existing revolving line of credit with CFC are secured by a Mortgage and Security Agreement dated November 11, 2008 and includes all assets of the Association. The Company has a $1.0 million revolving line of credit with CFC that was authorized by the Commission in Docket 08-027-01 and has a balance of $250K as of December 31, 2009. The total amount due to CFC including the revolving line was $1,843,821 as of December 31, 2009.

DISCUSSION

Information used in the Division's analysis included:

1. Audited financial statements for Flowell Electric Association, Inc. for years ending December 31, 2005 through December 31, 2009.
2. National Rural Utilities Cooperative Finance Corporation (CFC) proposed Loan Agreement, Secured Promissory Note and Restated Mortgage and Security Agreement.
3. Certificate of Resolutions and Incumbency dated May 11, 2010.
4. Correspondence with Gary Dodge and Durand Robison.

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.

<u>Historical Results</u>

Exhibit 1 is a summary of the audited income statements, balance sheet, and cash flow information for 2005 through 2009. The income statement shows an average annual increase in total revenue of 10.2% from $1.406 million in 2005 to $2.073 million in 2009. 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 83% 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 420 to 459 for the periods under review for an average of only 10 new customers per year.

Operating expenses grew from $1.251 million to $1.756 million for an average annual growth of 8.86%. The cost of purchased power as a percentage of total sales fluctuated from a high of 53.69% in 2006 to a low of 44.58% in 2009. Net margins have remained positive for all years under review but have experienced dramatic swings. Year-end 2006 and 2008 showed modest net margin of $42 thousand and $31thousand while 2005, 2007 and 2009 showed margins of

$137 thousand, $305 thousand and $218 thousand. This is primarily due to a rate increase of 5% in 2006 and a second increase of 10% in 2009. The Company has been very responsive to increasing rates as needed and has received favorable support from its members.

The balance sheet information shows a decrease in cash from a high in 2007 of $178 thousand to $36 thousand in 2009. Net Plant and Equipment showed an increase in 2006 and 2007, which was the last major plant addition. Slight increases were noted for 2008 and 2009 and were funded using internal cash. The cash position should be improving with the rate increase in 2009 and the approval of this application for additional long-term financing.

Total liabilities increased 34.57% from $667 thousand to $2.187 million. The increase in liabilities is due to additional long term debt which increased from $99 thousand in 2005 to $1.557 million in 2009. Patron's Capital increased 12.80% from 2005 to 2009 and increased from $920 thousand to $1.489 million. The Company's regulatory Capital Structure shows Long-Term Debt of 51.07% and Common Equity of 48.93% as of year-end 2009.

The ratio analysis for year end 2009 shows a current ratio[1] of .66 and a quick ratio[2] of 0.27. The interest coverage ratio (Times Interest Earned[3]) is calculated at 2.70 for 2009 compared to the average of 2.73 for the years under review. Return on Total Capital[4] for 2009 is calculated at 10.96% compared to the historical average of 10.79%.

[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 patrons capital.

Loan covenants in the new agreement have not changed and require a minimum Debt Coverage Ratio[5] of 1.35. As of 2009 the Debt Coverage ratio is calculated at 2.79 with the average for all years under review of 2.61. The Company has been in compliance with the loan covenants for all years under review.

Forecast 2009 to 2013

The Division has prepared forecasts based on historical data from 2005 to 2009. Exhibit 2 shows the forecast income statement, balance sheet and ratio analysis for 2010 through 2013. In addition to the forecast years, actual information for 2008 and 2009 has been included for comparison. Based on the historical averages and assumptions for future years, the forecast indicates that the Company will be able to meet its financial obligations and will remain in compliance with the covenants established in the CFC Loan Agreement.

The forecast uses a 5.00% annual increase in total revenue, which is significantly less than the 10.20% historical growth rate. The projected lower sales growth has been used to reflect the recent economic slowdown and national conservation efforts. Projected expenses as well as Property Plant and Equipment have been calculated using historical averages.

The forecast values calculate the financial ratios for liquidity, solvency and profitability near the historical averages. For the forecast periods, the common equity under the regulatory capital structure increases from the actual 48.30% in 2009 to 56.81% by 2014.

The Company has indicated that the Board of Directors has approved the proposed transaction at its meeting held on May 11, 2010 and provided a certificate of resolution as exhibit A with the application.

[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 increase the commitment with CFC to $2.0 million.

cc: Durand Robison, General Manger, Flowell Electric Association, Inc.
Gary A. Dodge, Attorney for Flowell Electric Association, Inc.
Michele Beck, Office of Consumer Services