State of Utah
Department of Commerce
Division of Public Utilities

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ACTION REQUEST RESPONSE

To: Utah Public Service Commission

From: Division of Public Utilities

Chris Parker, Director
Artie Powell, Manager, Energy Section
Doug Wheelwright, Technical Consultant
Jeff Einfeldt, Utility Analyst

Subject: Docket No. 17-506-01, Application of Deseret Generation & Transmission Co-Operative for Authority to Issue Securities in the Form of Secured Promissory Note to National Rural Utilities Cooperative Finance Corporation,

Date: October 10, 2017

RECOMMENDATION (APPROVAL)

The Division recommends that the Commission authorize Deseret Generation & Transmission Co-Operative (Deseret, or the Company) to issue securities in the form of an extension of the current $20 million revolving credit facility. The requested modification will extend the maturity date from November 30, 2017 to November 30, 2018.

ISSUE

DG&T requests authorization for authority to issue securities in the form of an extension in the maturity date for the existing line of credit with the current lender, National Rural Utilities Cooperative Finance Corporation (CFC). The proposed extension is being requested in order to allow additional time to complete discussions with CFC concerning long term lending agreements. In addition, Deseret is exploring alternative sources of future potential working capital financing, which could involve other financial institutions.

The original $20 million revolving line of credit was approved by the Commission on October 5, 2011 under Docket No. 11-506-01 with a maturity date of October 16, 2016. On October 7, 2016, the Commission approved a one year extension with a maturity date of November 30, 2017. To date, the Company has not drawn on this line of credit and there is no outstanding balance. The revolving line is secured by an existing mortgage on all of the Company's property, excluding the office building located in South Jordan, Utah. In addition to the Company assets, the loan agreement includes a guarantee from the Company's wholly owned subsidiary, Blue Mountain Energy, Inc. ("BME"). If approved, the maturity date for the revolving line of credit will be extended to November 30, 2018 with no change to the commitment amount.

DISCUSSION

Information used in the Division's analysis included: the Company's Application; Amended Promissory Note; Amended Revolving Line of Credit Agreement; and Amended Mortgage Security Agreement. In addition, the Division has reviewed the financial information in FERC Form 1 Annual Reports for years ending December 31, 2011 through December 31, 2016 along with the quarterly FERC financial information through June 2017. In addition, the Division has had correspondence with David Crabtree, Vice President and General Counsel concerning questions relating to the application and the financial information. The Company has indicated that the proposed extension has been reviewed and approved by Deseret's governing Board, which represents all six of Deseret's members. Deseret does not anticipate any changes to its member rates due to extending the maturity date on the line of credit.

BACKGROUND

Deseret was formed in 1978 and supplies wholesale electricity to its members and other bulk energy customers in Arizona, Colorado, Nevada, Utah, and Wyoming. The Company is owned by its six members: Bridger Valley Electric, Dixie Escalante Rural Electric, Flowell Electric, Garkane Energy, Moon Lake Electric, and Mt. Wheeler Power. The member-owned utility operates 223 miles of transmission lines, and has interests in two power generation facilities in Utah with approximately 550 MW of capacity. The primary generating resource, the Bonanza Power Plant is consistently ranked among the top environmentally clean coal fired plants in the United States. Deseret has an 88.13% ownership interest in this facility with the remaining 11.87% owned by Utah Municipal Power Agency (UMPA). Deseret owns and operates its own coal mine under Blue Mountain Energy (BME), which fuels the Bonanza power plant. In addition, the Company has a 25.10% ownership interest in the Hunter II power generation unit, which is operated by PacifiCorp.

Deseret has faced financial difficulties in the past leading to a series of arrangements for restructuring and recapitalizing the Company's indebtedness. The last such restructuring occurred within the 1996 to 1998 time frame and resulted in an agreement with CFC known as the Obligations Restructuring Agreement (ORA) and the 1998 Recapitalization Agreement. The renegotiated payment terms provided for stipulated quarterly minimum payments and an additional contingent payment based on a percentage of the year-end cash balances, less working capital reserves. CFC is the primary lender and as of June 30, 2017, the Company had $156.3 million in outstanding debt of various maturities.

<u>Historical Information and Financial Results</u>

By structure, DG&T is an electric generation and transmission not-for-profit co-op and is "upstream" from its six owner/members, which are not-for-profit co-op electric power retailers. The revenues received from its member co-ops can be controlled according to Deseret's cash flow needs and has historically shown little net profit. Exhibit 1 is a review of the historical financial results for year-end 2013 through 2016 along with year-to-date information through June 2017. The financial information includes balance sheet, income statement, cash flow, and ratio analysis for comparison.

Page 1 of Exhibit 1 shows that total revenue has remained flat with an average annual increase of 0.42% from $218 million in 2012 to $222 million in 2016. Operating expenses were lower in 2016, primarily due to lower fuel cost. Interest expense was lower in 2016 and has decreased from a high of $33.9 million in 2014 to 28.1 million in 2016. Historically, net income has been fluctuating every other year due primarily to a 2-year maintenance cycle, however more recently, the Company has reported net losses each year from 2012 through 2014. The Company reported a net income of $10.4 million in 2015 followed by a net loss of $3.4 million in 2016. The Company indicated that recent rate increases are partially reflected in the earnings for 2015 and will continue to help profitability in future years. The increase in profitability for 2015 is also attributed to lower fuel cost due to low cost production from the Company owned coal mine.

The balance sheet information on page 2 shows unrestricted cash at $6.7 million and restricted deposits at $23.1 million for 2016. Restricted deposits are designated as funds reserved for future service or transmission studies. Total current assets have decreased by 6.2% annually from 2012 to 2016 primarily due to the decrease in restricted deposits. Net plant and equipment decreased 4.13% annually from $181.1 million in 2012 to $152.9 in 2016. Total assets decreased by an average of 5.04% annually from 2012 to 2016.

Total liabilities have decreased by an average of 5.52% annually with the largest decrease coming from reductions in long-term debt. Long-term debt has been reduced from $252.3 million in 2012 to $165.4 million in 2016 for a 10.02% annual decrease. Total Patronage equity has decreased by an average of 2.92% for the periods under review.

Page 3 of Exhibit 1 provides a summary of the cash flow statements for each year. The Company has maintained a positive cash balance each year but alternates between an increase and decrease in cash every other year, which coincides with the maintenance schedule.

Page 4 of Exhibit 1 calculates the Company's financial ratios for each year under review. The current ratio[1] as of 2016 was 3.18, which was lower than the historical average of 3.81 but is not a concern at this time. The quick ratio[2] of 1.14 is also close to the historical average of 1.25. The long-term solvency ratios are also close to historical averages.

The capital structure has remained consistent for the periods under review, however it should be noted that the Company is highly leveraged. As of year-end 2016, the Company's regulatory capital structure was 72.4% debt and 27.6% equity. This is close to the historical average of 75.4% debt and 24.6% equity.

CONCLUSION

The application is a request to extend the existing credit facility for an additional 12 months with no increase to the dollar amount. The current revolving credit line has not been utilized and has no outstanding balance. The Division recommends that the Commission approve the Application of Deseret Generation and Transmission for authority to issue securities in the form of a 12 month extension to the existing $20 million revolving credit facility with CFC.

cc: David F. Crabtree, General Counsel, Deseret Generation & Transmission
Michele Beck, Director, Office of Consumer Services

[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.