Tennessee Valley Authority

Q1 Fiscal Year 2020 Investor Media Call

February 5, 2020 at 9:30 a.m. Eastern

CORPORATE PARTICIPANTS

Jeff Lyash – *President and Chief Executive Officer*

John Thomas – *Executive Vice President and Chief Financial Officer*

Tammy Wilson – *Vice President, Treasurer, and Chief Risk Officer*

PRESENTATION

Operator
Good morning, everyone, and welcome to the Tennessee Valley Authority's First Quarter Fiscal Year 2020 Conference Call. For your information, today's conference call is being recorded. All participants will be in a listen-only mode. Should you need assistance, you may signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star and then one. To withdraw your questions, you may press star and two.

At this time for opening remarks, I would like to turn the call over to Ms. Tammy Wilson, TVA Vice President, Treasurer, and Chief Risk Officer. Ms. Wilson, please go ahead.

Tammy Wilson
Thank you, Jamie. Good morning, everyone, and welcome to the Tennessee Valley Authority's First Quarter Fiscal Year 2020 Financial Review. As always, we appreciate your interest in TVA and thank you for your support of TVA's funding program over the years.

Today I have with me TVA's Chief Executive Officer Jeff Lyash, and TVA's Chief Financial Officer John Thomas. Jeff will begin with the business update, and then John will follow with the review of TVA's financial performance. After our prepared remarks, the call will then be opened up to give participants the opportunity to ask questions.

Now for a few housekeeping items. Today's press release and TVA's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2019, are available on TVA's website, and that's www.TVA.com. A replay of this call is also be available on our website for a period of one year.

Today's discussion may include forward-looking statements that are subject to risks and uncertainties, so please refer to our Quarterly Report on Form 10-Q for the quarter ended December 31, 2019, and TVA's Annual Report on Form 10-K for the fiscal year ended September 30, 2019, for a discussion of these factors.

And with that, I will now turn the call over to TVA's President and Chief Executive Officer, Jeff Lyash. Jeff?

Jeff Lyash
Thank you, Tammy. Good morning, everyone, and thank you for joining us on today's call. I hope everyone had a safe start to 2020.

On our last call, it was my pleasure to say that TVA's performance for fiscal year 2019 was among the strongest we've seen in recent history. In fiscal year '19, we achieved our 20th consecutive year of delivering power at 99.999% reliability. That's five nines.

The TVA Board approved a new integrated resource plan, a new ten-year strategic financial plan, and a new long-term partnership option for our local power companies, setting TVA on a path for sustained future success. And, TVA also reduced its debt by $1.5 billion, driving our debt to the lowest level in almost 30 years. So, 2019 was a great year for TVA, and we continued to build on these positive results during the first quarter of 2020.

We're working on several focus areas this year. First, we want to continue to strengthen partnerships with our customers. The long-term Valley partnerships strengthen the service that TVA and our local power company customers can provide to the nearly 10 million people we collectively serve. Partners that sign up for these 20-year agreements receive a monthly bill credit equal to 3.1% of wholesale demand, energy, and grid access charges. And, these partners will be more involved in TVA's long-term business planning, helping to guide our shared direction. Some customers are still evaluating the Valley partnership option versus their current contracts, and we hope more will join us.

We're pleased that on January 24th, one of TVA's largest customers, Chattanooga EPB, signed the partnership agreement. That brings our total today to 135 local power companies that have signed a 20-year partnership agreement with TVA. This has increased the average contract term from approximately 7 years to over 15 years. These customers are already starting to see the financial benefits of their new partnership with TVA. In fact, $34 million in wholesale bill credits were returned to partners in just the first quarter. We hope that all of the local power companies serving the Tennessee Valley will join us and share in the benefits that the long-term partnership option provides.

I was also pleased to name Jeannette Mills as TVA's new Executive Vice President and Chief External Relations Officer. Jeannette officially joined the TVA team earlier this week. She brings over 30 years of experience in the energy and utility sectors and has a strong track record. And, one of her main focus areas will be continuing to strengthen relationships and partnerships with customers and stakeholders across the Valley.

In addition to strengthening our partnerships, we want to maintain low rates. This is one of the most important considerations for our partners, our other local power company customers, and for our direct-served industries. We avoided a base rate increase in 2020 and the new strategic financial plan approved by the TVA Board last year outlines our plan to maintain steady base rates in the coming years.

Third, we will continue to excel in power operations, particularly in our nuclear facilities. TVA's goal is to have the best nuclear fleet in the country, and part of having the best fleet is investing in our nuclear plants. To that end, TVA completed physical work for the Browns Ferry Extended Power Uprate, or EPU project, in fiscal year 2019, significantly increasing the amount of carbon-free generation capacity at the plant by 465 megawatts. That's enough to power approximately 280,000 homes. And, we continue to study further technology upgrades, as well as potential operating license renewals across our entire nuclear fleet.

Fourth, we want to leverage innovation and technology across our operations. For example, TVA's Grid 2023 initiative is preparing us for the future energy market. Important parts of that initiative include completing the new state-of-the-art operation center being built in Meigs County, Tennessee, and completing enhancements to our fiber network.

On December 17th, TVA became the first utility in the nation to successfully obtain approval from the Nuclear Regulatory Commission to potentially develop small modular reactors at one of our sites. The 20-year permit, referred to as an early site permit, validates that the Clinch River site, near Oak Ridge here in Tennessee, is suitable for the safe development of an SMR facility. We're glad to be working in partnership with the Department of Energy to help drive the development of this next generation nuclear technology.

And finally, we're focused on continuous improvements in our business and operations that will help us better serve our customers and the 10 million people that live and work in the Tennessee Valley.

One focus area for TVA that will not change from year to year is delivering reliable power on a daily basis to all of our customers. I already mentioned that TVA achieved five nine's reliability for the 20th consecutive year. That's an impressive track record of reliability but it's even more impressive that our fleet continues to perform so well in the face of adverse weather conditions. Abnormally cold fall temperatures produced the coldest November day since 1979 and the highest TVA peak load ever for that month, at 27,722 megawatts. In addition to the cold November, calendar year 2019 was also the second wettest year on record for TVA, following record-setting rainfall in 2018. During this extreme weather, TVA's diversified portfolio maintained reliable power throughout our service territory. This reliability is a result of many factors, including investment in our fleet, the dedication of our workforce, and the desire for continuous improvement and performance excellence.

In addition to our ongoing work to ensure resiliency, we continue to support cleaner energy. TVA's 2019 integrated resource plan calls for significant solar and storage additions to the system over the next 20 years. In 2019, TVA signed four power purchase agreements for 674 megawatts of solar generation at sites in Tennessee and Alabama. Already in early 2020, TVA signed five additional agreements for 484 megawatts of solar generation with 50 megawatts of battery storage. This is expected to come online in 2022.

And, on January 22nd, we announced our first Green Invest program project. This program uses a competitive bid process, managed by TVA, to match demand for green power from large business and industrial customers with supply from new projects in the Valley. The first Green Invest program is a partnership between TVA, Nashville Electric Service, and Vanderbilt University. It will help Vanderbilt meet its future carbon and emissions reduction goals. We expect additional Green Invest projects to be announced in the months ahead.

TVA is also evaluating a site in North Alabama to potentially build our own utility-scale solar projects. We're in the process of performing technical, environmental and cultural reviews and this will determine what we can build there. Any TVA-built solar projects will be part of our broader strategy, consistent with the direction of our integrated resource plan to bring additional solar energy resources to the TVA system, along with our customer-led and other programs.

TVA also has more than 1,200 megawatts of wind power contracted and in operation. Our power system is already one of the cleanest and most diverse in the nation. On average, more than 50% of our energy that we produced during the first quarter came from carbon-free sources. And as a matter of fact, this morning as I looked at our system, over 70% was being produced by nuclear, hydro, wind, and solar—all carbon-free. We're a leader in dramatically reducing carbon and other emissions and supporting additional renewables is an important component of providing even cleaner energy in the future.

The first quarter of fiscal year 2020 was another solid quarter for economic development activities, as companies announced capital investment of over $2.4 billion, and the expected creation or retention of more than 27,500 jobs in the Tennessee Valley.

We're very pleased with Amazon's announcement of a new state-of-the-art fulfillment center in Memphis. This will create 1,000 new full-time jobs. This was a true economic development success story, brought about from the joint efforts of the State of Tennessee, local governments and organizations, economic development agencies, MLGW, and TVA. MLGW and TVA were vital partners in the project—the project that led to Amazon's announcement. This announcement further expands Amazon's footprint in Tennessee and the presence of high-tech internet companies across the Valley. It's notable that Amazon has already invested more than $6.5 billion in Tennessee since 2010, and this announcement demonstrates the powerful impact that TVA's partnerships with MLGW, the city of Memphis, and others can have in our communities. This is economic development and growth that directly impacts lives for new jobs and opportunities, which is exactly what TVA's mission of service is designed to accomplish.

Let me now turn the call over to John Thomas to provide you with details on TVA's financial performance during the first quarter of fiscal year 2020. John?

John Thomas
Thanks, Jeff. I'll begin with the highlights for the first quarter. Overall operating revenues were lower by 5%. This was driven predominantly by weather. This year was milder than last year, although I would say this year if you look at the heating and cooling degree days was essentially normal but compared to last year, it was milder.

Overall, effective rate for our customers, I'll talk more about this later, was 2% lower. Fuel and purchase power expense was lower as we continue to see the benefits of this diversified fleet that we've built. Overall interest expense is lower as we continue to reduce our debt balance. And, net income was $192 million, or roughly half of what it was last year.

In terms of overall power sales, you can see roughly 4% lower than last year, again as I said, that was driven by weather. If you come down and focus on the rate, as Jeff said, what we've been doing is working to ensure that we have the lowest rate feasible for our customers. Going back to 2013, we've been able to hold our overall effective rate flat for our customers. And, if you look at the first quarter of this year, you can see relative to last year, we continue to accomplish that with it down approximately 2%. The biggest impact here you can see is on the fuel rate. It's about 11% lower, which is driven by this investment we've made to further diversify and add low-cost fuel sources for our customers.

If you look at how this diversified fleet played out this year versus last year, you can see the addition of the uprates at Browns Ferry contributing to more low cost nuclear. Overall it was relatively wet this year but not as wet as last year, so we didn't have as much hydro, but we dispatched more natural gas and overall gas prices were about $0.50 MMBtu lower this year than last year. So, you can see the ability to move from different sources to optimize, to provide the lowest fuel cost providing value for our customers.

Overall, from a financial statement perspective, with the lower sales, we had lower revenues of $147 million. However, roughly $100 million of that was driven by the lower fuel expense. While some of that was volume, most of it was the benefits of the diversified fleet I mentioned. Overall operations and maintenance expenditures were lower, about $56 million. That was predominantly driven by our nuclear re-fueling outages. Those tend to vary from year-to-year. This year we had 41 days of nuclear re-fueling outages. Last year, we had 101. So, underneath this, our overall controllable O&M, we continue to see good progress, and offsetting the impacts of inflation.

In terms of depreciation and amortization, it's up but this is the impact of the decisions to accelerate Bull Run and Paradise. That was made in the second quarter of last year, so there was no accelerated depreciation in the first quarter. Year-over-year you see of that $239 million, roughly $225 million was accelerated depreciation.

And then, you can see bottom line overall net income at $192 million; that's $231 million less than last year. The swing here really being the fact that we had lower revenues because of the weather. We had lower expenses but then we had higher depreciation expense.

When you translate this into cash flow from operations, what you can see is with roughly $200 million less than net income, we end up with about $300 million more in operating cash flow. This really has to do with the fact that the depreciation expense is a non-cash item. It has to do with last year, although we had more revenue, that revenue really was collected in the second quarter from a cash perspective. And so, just the timing of the cash flows is where you see that $336 generated. Overall, roughly the same level of investing, and so this year we saw a reduction in finance activities of about $243 million. Overall total financing and debt obligations sitting at $22.6 billion, and as Jeff said, the lowest level in roughly 30 years.

So, overall, a good start to the first quarter. Our main objective here: keeping rates low and stable for our customers. We accomplished that. The partner benefit credits that the customers are seeing; overall lower fuel and purchase power expenses of this diversified fleet; and the benefits of lowering debt resulting in lower interest expense.

So now, I'll turn it over for your questions.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time, we'll begin the question-and-answer session. To ask a question, you may press star and then one. If you are using a speakerphone, we do ask that you please pick up your handset before pressing the numbers. To withdraw your question, you may press star and two. Once again, that it is star and then one to ask a question. We'll pause momentarily to assemble the roster.

Our first question today comes from Carrie Saint Louis from Fidelity. Please go ahead with your question.

Carrie Saint Louis
Hi, good morning.

Jeff Lyash
Good morning, Carrie.

Carrie Saint Louis
I just wanted to follow up on two things. So, obviously, a good level of debt, strong cash flow. Just curious where you are for funding needs for this year.

John Thomas
This is the time of year where we're staring at the summer and saying it really depends on what happens as we get through the middle of the year. We have a $1 billion maturity coming up in March. And so, it would be reasonable to think with that $1 billion maturity that probably later in the year, sometime in the summer or later, we'd be looking if we come back in the market.

Carrie Saint Louis
Okay. Great. And then, could you just comment on your Board right now, what's the Board composition? Are all seats full? Do you have any expirations coming up? If you can just comment on that.

Jeff Lyash
Carrie, our board is nine members and they're appointed by the President. We had two members, Gina Lodge and Ron Walter, end their terms at the end of the congressional session last year. So, we currently have seven active board members. And, we have two members—the White House issued an

intent to nominate notice a week or so ago identifying two individuals that will now go through the vetting and nomination process to replace Ron and Gina. And so, we're hopeful that we'll see that run its course and we'll seat those members here during 2020.

Carrie Saint Louis
And then I guess it's probably too soon to know but obviously budget, any views or any comments? I know you guys have sometimes had studies ongoing with different government agencies. Obviously, your debt is down quite a bit. Your costs are down. But, do you anticipate anything mentioning TVA in the budget this time?

Jeff Lyash
Yes, Carrie, it's really hard to say. In the past, TVA has been mentioned, including discussion of sale. We really don't see support for that politically, and certainly not among our 10 million customers, especially as TVA performs better and better. So, while it wouldn't surprise us, and we'll certainly respond to it, we're pretty confident that the Valley public power model that's currently running is performing well and has strong support and it'll stay intact.

Carrie Saint Louis
Okay, and then lastly, and forgive me if you talked about this on the call, I was a little bit late, but I know that there was, I believe, you were trying to move some of your larger members onto a new rate structure. I was wondering if you could just give us an update on where that may stand?

Jeff Lyash
Yes, Carrie, I think I did mention it earlier, but I don't mind covering it again. We offered as an option, our 154 local power companies, a long-term partnership proposal. And, it's 20-year proposal. And, it includes a number of benefits: a more active role in our decision making, the ability to begin to serve some of their own load with distributed energy resources. We think that's important so that we can build distributed resources, particularly renewables, into the portfolio. And, it offers them a 3.1% reduction in their bill.

Just a couple of weeks ago, Chattanooga, one of our largest customers, executed that agreement. And, that put us at 135 of 154 of our local power companies on the 20-year agreement. So, fundamentally, that increased our average contract duration from something less than 7 years to about 15 years on average. Most of the rest of the 19 are continuing to evaluate and do their due diligence. And, we're hopeful that some significant percentage of those will elect to come on board with that agreement during 2020, but time will tell.

Carrie Saint Louis
And, can you just help me on two things? So, one, obviously each customer, those 135 out of 154, I'm assuming that's not the relative concentration of them from a load perspective. So, how much would you say of your load is represented by that 135?

John Thomas
So, we have about 90% of our load is local power companies. About 10% is direct-serves. So, 75% of the local power company load is covered through that. If you add in the 10% direct-serve industry that we support, all of a sudden, you're up at 85% covered through either direct-serve industry or local power companies. So, it's rather significant.

Carrie Saint Louis
And then, do you have an expiration for this other 19 to take this plan? Is there a deadline or is there an open situation? I'm not too familiar.

Jeff Lyash
Carrie, we want our customers to have the choice. And I imagine at the end, there will be customers on a five- or a ten-year contract who want to remain on that for their own reasons. And, we're fine with that. So, there's no expiration or shelf life on this option. It'll remain on the table for the customers who may want to take it now or later.

Carrie Saint Louis
Great. Thanks for that update, very helpful.

Operator
Once again, if you would like to ask a question, please press star and one.

Our next question comes from Kristi Swartz from E&E News. Please go ahead with your question.

Kristi Swartz
Hi, good morning. Just a couple of questions here. First of all, Senator Sanders came out with a climate plan and he's putting a lot of focus on the public power markets, one specifically involves TVA. He's talking about investing more than a $1 trillion in the power markets and also in TVA to develop renewable energy and storage. I wasn't sure if you've paid any attention to his plan. Do you have any thoughts on that or whether it's even feasible?

Jeff Lyash
Yes, well, we certainly pay attention to everything that's going on in the energy sector. Things are changing quite rapidly.

What we're focused on is taking all the cost-effective actions that we can take to reduce our environmental footprint. It's important to us—you'll recall that at our founding we're focused on energy at the lowest feasible price, environmental stewardship, and economic development. These three things are linked very closely. We're always looking for ways to improve our environmental position without harming the economy or raising customer price.

As we have increased our nuclear production, optimized our hydro fleet, added renewables like wind and solar, and retired coal, we've been successful at reducing our greenhouse gas emissions against the 2005 benchmark by 60%. And, we have line of sight on a 70% reduction by 2030, and we're looking toward further reductions beyond that.

Our focus is doing that without raising the customers' price. And so, you heard us talk early in the call about continuing now and accelerating our solar additions at the system level and working with large customers and through our flexibility options working with local power companies. And, we're looking at perhaps up to 10 gigawatts of solar over the next 10-to-20 years and that will continue to drive down our carbon emissions.

So, the answer to your question is, we look at what all the candidates and the current administration are focused on but for us, we're going to continue to march down the path of reducing greenhouse gas while we keep the customers' price as low as reasonable.

Kristi Swartz
Great. I appreciate that. I wanted to—you were riffing off a nuclear—you said you were looking at your fleet for additional license extensions. I know I can look this up on the NRC site, but just help me a little bit. Is some of this tacking on an extension another 20 years from 40 years, or are you looking at what

some of the other utilities are now adding an additional 20 that would have them run up to 80 years?

Jeff Lyash
Yes, we're looking at the 60- to 80-year subsequent life extension. We have seven nuclear units. They are extremely well-designed and maintained. We have already made significant capital investments across the board, replacing equipment, modernizing plant. And we're in the process now of doing the technical and economic studies to make a decision on this subsequent license renewal, which is the extension from 60 to 80 years, because at least at the outset of our reviews here, this looks like a very cost-effective, long-term source of power for our customers. And, it helps us—as a matter of fact, it's key to us continuing to be able to reduce our greenhouse gas emissions.

Kristi Swartz
All right. Great. Thank you so much.

CONCLUSION

Operator
And ladies and gentlemen that will conclude today's question-and-answer session.

At this time, I'd like to turn the conference call back over to Jeff Lyash for any closing remarks.

Jeff Lyash
Okay, well, again, thank you for your time this morning, and thank you for your questions. We're already hard at work implementing TVA's strategic financial plan with our long-term partners. We're united by a common mission, serving the people of the Valley to make life better. And, I assure you that we're dedicated to fulfilling this mission every day in fiscal year 2020 and beyond.

So, thank you for your time this morning, folks. Have a good day.

Operator
Ladies and gentlemen, the conference has now concluded. We do thank you for attending today's presentation. You may now disconnect your lines.