Tennessee Valley Authority

Third Quarter Fiscal Year 2019 Investor Media Call

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CORPORATE PARTICIPANTS

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

Jeff Lyash – *President & Chief Executive Officer*

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

PRESENTATION

Operator
Good morning, everyone, and welcome to the Tennessee Valley Authority's Third Quarter Fiscal Year 2019 Conference Call. For your information, today's call is being recorded. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero.

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. It's hard to believe that it's already August, and in fact, many kids here in Tennessee will be starting school next week. It's also time for TVA's third quarter fiscal year 2019 financial review. Today, for our call, I have with me TVA's Chief Executive Officer, Jeff Lyash and TVA's Chief Financial Officer, John Thomas.

Jeff will begin with a business update, then John will follow with a review of TVA's financial performance. After prepared remarks, the call will 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 quarter ended June 30, 2019 are available on TVA's website, and that's www.TVA.com. A replay of this call will also be available on TVA's website for a period of one year.

Today's call may also include forward-looking statements that are subject to risks and uncertainties so please refer to our quarterly report, that is form 10-Q, quarter ended June 30th of 2019, and also TVA's annual report, 10-K, for fiscal year ended September 30, 2018 for a discussion of these factors.

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

Jeff Lyash
Thank you, Tammy. Good morning, everyone, and thank you for joining us on today's call. As you all know, I'm a strong supporter of the Public Power Model and the principle behind TVA's mission. That mission includes delivering reliable power at the lowest feasible cost, caring for our region's natural resources, and creating and investing in sustainable economic growth. When we fulfill all parts of our mission, TVA adds significant value to our stakeholders, and it's important to continuously collaborate with our stakeholders to ensure that we're providing the greatest possible value.

The first step in this collaborative process is to listen to what those we serve have to say. That's why I've spent a considerable amount of time over my first 100 days traveling throughout the Tennessee Valley, and doing that to listen to our employees, our customers, local governments, and to community leaders. Some of these listening sessions produced action items that we've already implemented. For example, we've made organizational changes to better focus on two areas in particular: our customer relationships, specifically with Memphis Light, Gas and Water, and dealing with coal combustion residuals, also known as coal ash.

I recently asked two of our top executives to focus on each of these areas with the ultimate goal of ensuring that we do the right thing on both. These leaders bring a depth of knowledge and strong technical, environmental and stakeholder relations experience to this work. The TVA team will develop an integrated strategy to better coordinate our efforts as we identify ways to strengthen relationships and address questions that the community and our customers have for us in each of these areas.

It's important to remember that we aren't just listening to stakeholders in private meetings, but that we also seek to incorporate public input. For example, we routinely organize public meetings, listening sessions, webinars, and comment periods for the most important work that we do. A good example of this public transparency is the Integrated Resource Plan, or the IRP, process. After the draft IRP was released, TVA opened a 50-day public comment period and held public meetings in various cities as well as a public webinar. This public input helped shape the final IRP. This IRP will guide TVA as we continue to provide safe, reliable, and low-cost power for the next 20 years.

In order to ensure that we maintain our ability to lower carbon emissions while delivering affordable, reliable energy, TVA continues to invest in our power system, particularly in our nuclear fleet. With the completion of final testing on Unit 2 at the Browns Ferry Nuclear Plant, TVA has completed the extended power uprate, or EPU, project. This project will significantly increase the amount of generation capacity at the plant. When fully validated, the total additional output at Browns Ferry will be 465 megawatts. That's enough to power, approximately, 280,000 homes and perhaps, best of all, it does that carbon-free. We are proud of our EPU work at Browns Ferry and we're also proud of our maintenance program at our other nuclear facilities.

On April 13th, Watts Bar Unit 2 began its second ever refueling and maintenance outage. This after producing more than 13.5 billion kilowatt hours of electricity over the previous 18 months. During this outage, TVA focused on improving our plant systems to deliver safe, uninterrupted service for the valley for the next 18 months. The outage was comprised of more than 11,800 planned work activities and these activities were completed with zero injuries.

In keeping with TVA's dedication to performance excellence regarding our nuclear fleet, it's my desire to create sustainable, industry-leading performance in our nuclear organization. To meet that goal, I announced in June that Senior Vice President and Chief Nuclear Officer Tim Rausch will report directly to me. The nuclear organization's importance to our success can't be overstated, particularly as we move toward a cleaner energy future. I look forward to Tim's leadership and his drive for continuous improvement in this space to make our nuclear fleet the best in the country.

TVA has also made great strides in providing reliable, low-cost energy that is cleaner. And, just as we're pleased that carbon-free nuclear energy is an invaluable part of our generation mix, we're also pleased that renewable energy continues to grow in the valley. We previously announced partnerships to build solar facilities for Google and Facebook data centers totaling a combined 674 megawatts of capacity. In April, a 53-megawatt solar facility in Millington, Tennessee came online as a result of a partnership between the city of Millington, the U.S. Navy, Memphis Light, Gas and Water, and TVA.

The Millington Solar Facility is the largest in Tennessee and it provides the Millington Naval Base with an alternative electrical feed that will increase energy security and resilience at the base. In April, we also announced a request for proposal for an additional 200 megawatts of renewable energy. In May, BrightRidge, TVA, and Silicon Ranch flipped the switch on the Tri-Cities' first community solar project, a 5-megawatt facility near Telford. That's enough capacity to power more than 500 homes. TVA will continue to partner with customers on opportunities like these that support greater availability of renewable energy options throughout our service territory.

Trends in our industry, such as the decreasing cost of renewables, require that we keep pace with a rapidly changing marketplace. As a result, TVA decided to update its Integrated Resource Plan a little bit earlier than normal. The IRP Process provides us with direction on how best to meet the valley's energy needs for the next 20 years.

We released our final IRP and the associated environmental impact statement in June, after having received significant public feedback. The final IRP will be voted on by the TVA board at the August 22nd board meeting. We've kept the public informed and involved throughout the IRP development process by sharing information through open houses, webinars, social media, the TVA website, and meetings of TVA's Advisory Council on energy, the Regional Energy Resource Council.

The IRP will be an important resource as we continue to develop TVA's next long-range strategic plan. Over the next 20 years, we will see lower carbon and significant additions of renewable energy, particularly solar, along with more investment to maintain reliability. Along with the IRP, we'll be presenting our business plan for 2020 to the TVA Board for consideration later this month.

The third quarter of fiscal 2019 was another solid quarter of economic development in the valley. Fiscal year-to-date, more than 58,500 jobs have been created or retained and more than $8 billion of capital investment has been announced. Even as TVA runs its own business, we understand the need to stimulate economic development by investing in small and diverse businesses, businesses like Engineered Solutions. Engineered Solutions is located in Athens, Alabama and was recently named TVA's Diverse Supplier of the Year. Over the past five years, TVA has increased its annual spend with Diverse Suppliers by 65%, from $269 million to $449 million. We spent $822 million with small businesses last year, part of the $2.2 billion we spent with all valley businesses.

We're off to a great start in economic development and now, let me turn over the call to John Thomas to provide you with details on TVA's financial performance in the third quarter. John?

John Thomas
Thank you, Jeff. I'll begin with the highlights. Overall, operating revenues for the first nine months were essentially flat driven by essentially normal degree days. I'll get into more details on that in a moment. Overall, our operating expenses were higher, driven by non-cash items associated with the announced retirements of the Paradise and Bull Run coal units. Our overall interest expense is lower, as our overall debt level has come down, and our overall net income is lower primarily driven by the non-cash items I mentioned.

To start with weather and its impact on our results, while overall degree days were essentially normal this year, they were lower than last year when we had a really cold winter, and that impacts our year-over-year results. With overall degree days being lower than last year, you can see that our power sales were down 2%. Our overall operating revenues were essentially flat. Our base revenue was up because of the base rate increase that was enacted in October 1st of this year, but our overall fuel costs were down and offset that impact. That was primarily a result of lower volume and higher hydro generation.

In terms of our overall fuel supply, power supply, we had essentially the same amount of nuclear generation this year as last year, even though we had more nuclear refueling outage days. We had 174 planned nuclear refueling outage days this year versus 118 last year, but what you can begin to see is the impact of the power uprates at the nuclear facilities generating more low-cost carbon free electricity. In addition, you can see the impact of our hydro-fleet. We had a significant amount of rainfall so far this year, and hydro overall upped from 14% to 16% of our total generation but that doesn't really portray the significant impact when you look at just the amount of increase in hydro. Year-over-year, it's a 26% increase. Overall, you can see lower coal as the hydro was really displacing coal and this resulted in the lower effective fuel rate for our customers.

From an income statement perspective, as I showed previously, revenues are flat, fuel expenses are down by volume, and overall operations and maintenance expenses are up $408 million but you can see this is really driven by the write-offs associated with the retirement announcements at Bull Run and

Paradise and the acceleration of our Kingston environmental or regulatory asset. Lastly, you see, excluding those items our overall operations and maintenance was up $86 million, but that was really driven by the higher planned nuclear refueling outages.

Depreciation and amortization were up $124 million. This was due to the accelerated depreciation with Bull Run and Paradise. Overall, interest expense is lower, $40 million. That's because of the lower debt balance as we continue to reduce debt. The bottom line, then on net income, $829 million, we're roughly $400 million lower than last year.

In terms of our overall statement of cash flow, cash provided by operating activities was slightly less but essentially in line with last year, $2.5 billion worth of operating cash flow in the nine-month period of both years. Our investing activities, very consistent year-over-year at $1.5 billion and what that results in is $900 million worth of debt reduction this year, which is consistent with what we saw last year as well. Now our overall debt and financing obligations at the end of June were $23.4 billion.

Revenue is essentially flat for the year, operating cash flow and debt reduction consistent with the prior year, and we continue to improve our overall balance sheet and financial health.

Now, I'll turn it over to Jamie to queue up the questions.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time we'll begin today's question-and-answer session. TVA would like to provide the financial community with the first opportunity to ask questions. To ask a question, you may press star and then one on a touchtone telephone. If you are using a speakerphone, we do ask that you please pick up your handset before pressing the keys. To withdraw your questions, you may press star and two. Once again, that is star and then one to ask a question. We'll pause momentarily to assemble the roster.

Our first question today comes from Courtney Rushford from TD Securities. Please go ahead with your question.

Katie
Hi. This is Katie, actually, from TD. I had a question on the IRP because it definitely feels like it's a more aggressive approach to adding renewable generation, particularly in solar in the next few years, and I wanted to know, does it represent, really, a more aggressive approach to adding those resources and why.

Jeff Lyash
Thank you, Katie. I thought the IRP was extremely well done, lots of stakeholder input and much of the stakeholder input we got was around taking cost-effective steps to lower our carbon emissions profile and incorporating renewables where they were cost-effective. What we see with solar prices, we think we'll make it a cost-effective addition for our customers over the term of this IRP, and you see that reflected. What we're working toward here is satisfying some of the objectives that the citizens of the valley have set for us in terms of incorporating renewable but doing it in a way that doesn't add to their bill, rather does it cost effectively.

Katie
Thank you.

Operator
Our next question comes from David Flessner from *Chattanooga Times Free Press*. Please go ahead with your question.

David Flessner
Good morning and thanks for taking the call. On the non-cash write-offs with respect to the coal cleanup, first of all, is that a one-time thing or will that be a regular feature for some time? Where are you in terms of the allocation for the cost? I think the $640 million expense for digging up the coal ash cost and things, is that now fully allocated, or will there be additional expenses in future years on that?

John Thomas
Dave, this is John. There are really three components associated with—I'll start with Bull Run and Paradise in terms of the decisions to close those operating units. Initially, you have an impact that we're seeing this year, which is the write-offs that impact O&M. This has to do with inventory or capital projects that were in flight.

You see a second component, which is the accelerated depreciation and the accelerated depreciation we will continue to see over the period between now and when those operating units actually close. Then, there's a third element, which you bring up, which is the coal ash, and the coal ash will be recognized over a much longer period of time, essentially over the period in which we remediate activities associated with the coal ash. Those are really three different elements that'll be recognized over three different time periods.

David Flessner
As you approach the new fiscal year, this could be the fourth year you've had net income over $1 billion. As you look for rate adjustments for the next year, what is your approach about the appropriate level of earnings and income and looking at your balance sheet, what did you say, in terms of just an overall context of what rate adjustments may or may not be necessary to meet your future financial objectives? Aren't you earning as much or more than you need to at this point and what's your outlook for the next year, then, in that regard?

Jeff Lyash
Yes, Dave, I would make two points here. First, maintaining power costs as low as reasonable is core to the TVA mission and the whole team is focused on that, and the way we're accomplishing it is by becoming ever more efficient in lowering our operating and maintenance costs, leveraging this diverse fleet to keep fuel costs down, and making our facilities perform.

I'm optimistic as we look at the next decade that TVA's rates will be very stable and that we'll get progressively more competitive over that period of time. This is something we'll be addressing with the board at the August board meeting, where we will make our recommendation on rates for next year and lay out our forward-looking ten-year financial plan.

With respect to net income, I'm going to ask John to comment but remember, one of our objectives is to reduce TVA's debt, and TVA over the last six years has reduced that debt by almost $5 billion and our objective is to reduce it further over the coming years so that we meet the commitment that's been made to the Office of Management and Budget to be below $21.8 billion by 2023 and likely somewhat lower than that.

It takes net income to pay down the debt, that is essentially where our net income is flowing. It's to reduce the debt which lowers long-term financing costs for our customers and helps us deliver a lower price.

John Thomas
Yes, Dave, I'll just add, Jeff said it well. If you look at our net income this year versus last year, it's $400 million different but that's really not what's important. What's important is our operating cash flow is $2.5 billion in each year, and it really is generating that operating cash flow to service the debt to then be able to put TVA in a situation where both years we've reduced almost $1 billion, which is making us much more financially healthy. It's a significant movement from where we were five, six years ago, and it's nice to be in a situation where people are wondering if TVA is too financially healthy. It's an unusual one.

David Flessner
Are you ahead, then, of your own projections, your commitment to debt reduction at this point or you're on pace or where would you characterize where you are in that plan, the long-term plan you had laid out for debt reduction?

John Thomas
Yes, we are ahead of that plan and part of that is the rationale behind doing a new ten-year plan. Now that we're ahead of that plan, we can clearly see that we're going to meet that objective, probably a little bit early. If I were you, I wouldn't miss the August board meeting, where we go through what the next ten years look like.

David Flessner
I'll be there. Browns Ferry, are you at the uprate? Is that now fully in place? Can you talk about the timing on that? Have you now completed that or when would that occur that you would have full power, the additional power there, the 465 megawatts?

Jeff Lyash
Yes, Dave, that effort is complete now, all three Browns Ferry units are at their new maximum power level. It was quite successful. We came through the testing and the final validation very cleanly. I think it was a great effort by the whole nuclear team and it's going to pay dividends for our customers for a long time.

David Flessner
One final question, if I might. I don't want to monopolize it but you're making significant reductions, you said 58% of your production generation was non-carbon. You committed to 70% reduction but those that are proponents of no carbon release wonder about the long-term plan. Will you ultimately get to a zero-carbon emission strategy in the long-term? This IRP does not lay out any plans for that, you're still going to have carbon generation for decades to come. Right?

Jeff Lyash
Our objective, Dave, is to lower our carbon intensity as low as we can but doing it cost effectively. The customers we serve, the ten million people in the Tennessee Valley, the price and the reliability of electricity is vital to them, and we'll look for every opportunity to cost effectively reduce the carbon intensity of our fleet. We've done that in pretty significant steps since 2005. We're going to continue to do that and that's why we talk about a 70% reduction by 2030. If we can take it farther than that, cost-effectively, we will but that crystal ball is a bit cloudy right now.

David Flessner
Thanks.

Operator
Once again, if you would like to ask a question, please press star then one. Our next question comes

from Kristi Swartz from *E&E News*. Please go ahead with your question.

Kristi Swartz
Hi, good morning. I wanted to ask, really quickly, about nuclear going forward and the reason for that is I know, and you guys are well aware that the NRC is getting ready to look at the design for the SMRs. I know that TVA doesn't have any immediate needs to build generation, this is looking long out, but can you put a little bit of color on where you guys might see that, either at Clinch River or elsewhere, fitting into your strategy?

Jeff Lyash
Yes, sure. I'll just start out by saying that the most important thing we can do, in terms of maintaining our load and improving our low carbon intensity is to operate our existing nuclear fleet at the highest levels of performance and to extend the lives of those units if it's cost effective and safe. Beyond that, TVA maintains a resource that is engaged with monitoring, evaluating new nuclear technologies.

We have just recently completed the process for an early site permit for the Clinch River facility. That is intended to maintain the option for TVA some time in the future to build new nuclear, including small modular reactors. We clearly haven't made a decision to proceed with that, but I think it's important that we maintain that as an option and monitor how the economy develops, what our load does, carbon regulation, etc. We work closely with DOE and Oak Ridge and others on the technologies that might underlie that.

If we were to ever make a decision to proceed with that, it would have to be based on a need for that generation here, in the Tennessee Valley, and it would have to be cost-effective and an appropriate level of risk for our customers. No specific commitment but TVA will stay in close contact on this and keep the option open for the future.

Kristi Swartz
Great. Thanks so much.

CONCLUSION

Operator
Ladies and gentlemen, at this time, I'm showing no additional comments. I would like to turn the conference call back over to Mr. Jeff Lyash for any closing remarks.

Jeff Lyash
Again, thank you for your time this morning. At TVA, our mission is service, and we're dedicated to working together with our stakeholders to continuously strengthen and improve our partnerships. That collaboration involves listening to their needs and then following up on what we hear with action. The finalization of the IRP along with other initiatives I highlighted during the call illustrates our ongoing commitment to collaboration and transparency. In the end, this approach helps create the most value for the ten million people who count on us every day. Thank you all for your time today.

Operator
Ladies and gentlemen, that does conclude today's conference call. We do thank you for joining today's presentation. You may now disconnect your lines.