

PRESENTATION OF THE LAZARD REPORT TO TVA



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## Summary of Lazard's 2014 Strategic Assessment to TVA

- **TVA's strong financial position and ability to self-fund its short- and long-term programs suggested no impetus for the Federal Government to change course**
- **TVA's financing did not appear to be a draw on the Federal Government's balance sheet**
  - TVA was not expected to exceed its \$30 billion statutory debt limit by 2023 and was expected to significantly delever
- **Divesting TVA would likely be an incredibly complex, costly and multi-year process, with unclear practical achievability**
  - TVA's non-power mission would likely be negatively impacted if TVA were divested
  - The Federal Government would likely realize minimal, if any, value from a divestiture

## Lazard's Scope of Work for the 2021 Report to TVA

**Lazard's scope of work for its Report to TVA includes the following:**

- **Evaluate TVA's financial performance from 2014 through 2020 against TVA's 2014 long range financial plan**
  
- **Reassess whether the public power model and TVA's existing business structure is a reasonable approach to support TVA's missions by commenting on:**
  - TVA's professionalism
  
  - TVA's initiatives to support its mission
  
  - TVA's performance vs. that of other large utility companies

## The “Professionalization” of TVA over Time

- **TVA has increasingly adopted policies of private sector corporations and reduced its reliance on the Federal Government**
  - Today, TVA funds all of its operations primarily from the sale of electricity and power system financings
- **The Consolidation Appropriations Act of 2005 further aligned TVA with investor-owned corporations of similar size and scope**
  - TVA reorganized from a three-person full-time board to a Chief Executive Officer and a nine-person part-time board structure
  - TVA became subject to the Sarbanes-Oxley Act
  - TVA was mandated to publish regulatory filings, including annual and quarterly SEC reports
- **In recent years, TVA has successfully increased stakeholder transparency beyond its mandatory disclosures including by holding open houses, renewing the charters of TVA’s public advisory councils, etc.**

## **TVA's Performance—FY14 to FY20**

- **Performance exceeded expectations across all key relevant metrics**
- **Wholesale rates decreased (were forecasted to increase under FY14 Plan)**
- **Retail rates increased less than expected**
- **Non-fuel O&M expenses decreased more than expected**
- **Fuel & purchased power expenses decreased (were forecasted to increase)**
- **Statutory debt decreased more than expected**
- **TVA achieved its strategic total financing obligations goal three years ahead of schedule**
- **Other financial metrics met or outperformed TVA's FY14 Plan**

## TVA—Management Initiatives

- **TVA's management team has implemented a number of initiatives in furtherance of TVA's three mission areas:**
  - Energy Mission Area
  - Environment Mission Area
  - Economic Development Mission Area
- **Many of TVA's initiatives address more than one of TVA's mission areas**

## **TVA—Management Initiatives** (cont'd)

- **TVA's Integrated Planning Process is a comprehensive, enterprise-wide business planning exercise**
- **TVA has focused on its resource mix and expects its asset portfolio and generation resource mix to become even more modern and clean over time**
- **TVA offers a number of renewable energy programs to its customers**
- **TVA is a thought leader on innovation in its service area**
- **TVA funds and manages the Nuclear Decommissioning Trust (“NDT”) and Asset Retirement Trust (“ART”)**
  - The NDT is fully funded
  - The ART is a voluntary trust used to fund non-nuclear asset retirement obligations
  - TVA's forecasts show full funding of asset retirement obligations out of TVA's budget and ART



## **TVA—Management Initiatives** (cont'd)

- **TVA has made progress developing and implementing coal ash management initiatives and technologies**
- **TVA, with the support of its stakeholders, has created and retained over 475,000 jobs and attracted over \$61.5 billion of capital investment within TVA's service area between 2014 and 2020**
- **TVA's transformational long-term partnership proposal has resulted in 142 out of 153 LPCs becoming long-term partners and created value for multiple stakeholder groups**
- **After closing its pension plan to new entrants in 2014, TVA expects to have a fully funded pension by 2036 using conservative assumptions**
- **TVA has initiated a variety of environmental and natural resource stewardship programs designed to improve the quality of life and community safety in TVA's service area**

## TVA—Benchmarking Analysis

- **The scale of TVA’s operations rivals that of large, investor-owned utility (“IOU”) peers—the basis for the benchmarking analysis**
- **From 2014 – 2019, retail and residential rates modestly increased and industrial rates were reduced in TVA’s service area—these trends compare favorably to TVA’s regional IOU peers**
- **In 2019, retail rates in TVA’s service area were in the second-best quartile both nationally and among its regional IOU peers**
  - TVA estimates that retail rates will decrease in FY21 due to impacts from the pandemic relief credit and the long-term partnership credit and has seen progress in line with this expectation over the first two months of FY21
- **In 2019, effective residential rates in TVA’s service area were in the second-best quartile both nationally and among its regional IOU peers**
- **In 2019, effective industrial rates in TVA’s service area were in the best quartile both nationally and among its regional IOU peers**

## TVA—Benchmarking Analysis (cont'd)

- **In 2019, TVA's CEO had the lowest compensation among TVA's regional IOU peers, and the CEO's compensation was significantly below the median compensation of TVA's regional IOU peers**
  - TVA's CEO compensation is set in consultation with an independent consultant
- **TVA has meaningfully reduced average production non-fuel O&M and non-production non-fuel SG&A expenses since 2014, which are at levels lower than what was forecasted in 2014**
  - However, TVA's average production non-fuel O&M and non-production non-fuel SG&A expenses over 2017 – 2019 have been higher than those of its regional IOU peers
  - TVA is executing on measures to address these costs, and TVA has still performed well on rates as noted
  - It should also be noted that TVA's fuel expenses were in the best quartile
- **TVA now operates a relatively balanced generation mix and further delivers high transmission reliability compared to regional IOU peers**
- **TVA is lower ranked in certain metrics related to the availability of power generation**
  - This performance is related to decisions TVA is making with respect to how it operates its fleet

## **TVA—Benchmarking Analysis** (cont'd)

- **In 2019, TVA ranked first and second among IOUs in jobs created and corporate capital investment attracted, respectively**
- **In 2018, TVA was a leader among its regional IOU peers in respect of renewable energy net generation**
- **TVA's CO<sub>2</sub> emissions percentage reduction over 2005 – 2019 was in the best quartile among both its regional and national IOU peers**
- **TVA's 2017 – 2019 average CO<sub>2</sub> emissions intensity was in the second-best quartile among both its regional and national IOU peers**

## **TVA—Benchmarking Analysis** (cont'd)

- **TVA's 2014 – 2019 cumulative net external financing needs were the lowest among its regional IOU peers**
- **In 2020, TVA's capitalization was in line with that of its regional IOU peers, and TVA was more conservatively capitalized than the majority of its public power peers**
  - TVA has a much stronger credit rating relative to that of its regional IOU and public power peers
- **In 2019, TVA's pension was 60% funded**
  - After closing its pension plan to new entrants in 2014, TVA expects to have a fully funded pension by 2036 using conservative assumptions
  - TVA's pension funding status compares favorably to state retirement systems and city and county retirement systems
  - TVA's regional IOU peers had pensions that were more funded, albeit TVA's regional IOU peers used higher (i.e., more aggressive) discount rates—a pension's funding status can be significantly impacted by the discount rate used
- **In 2019, TVA ranked in the top and second-best quartile in its Recordable Incident Rate and Serious Injury Incident Rate, respectively**

## **TVA's FY21 Plan over the Next 10 Years**

- **TVA expects effective customer rates to remain relatively flat**
  
- **TVA plans to maintain a robust capital investment program and further stabilize its debt-to-capitalization ratio**
  
- **TVA's plan reflects a rate structure that will support the self-financing of its capital needs over the period**
  
- **TVA expects to decrease its reliance on coal over the period**

## **TVA's Current Positioning and Potential Business Models**

- **TVA has a wide array of strengths that reflect and have helped drive the significant progress TVA has made in advancing its mission since 2014**
- **TVA has a broad set of opportunities and is positioned for the future through its five new strategic priorities for gauging its performance going forward: Powerful Partnerships, People Advantage, Operational Excellence, Igniting Innovation and Financial Strength**
- **The public power model provides significant and differentiated value to TVA stakeholders**
- **Lazard believes that its previous conclusions in the 2014 Strategic Assessment with respect to the benefits and considerations of alternative business models vs. the public power model are still valid today**

## **TVA—Public Power Model Value to TVA Stakeholders**

- **Federal ownership supports affordable rates without any taxpayer appropriations**
- **Mission-driven mandate allows TVA to focus on the best interests of its stakeholders**
- **Anti-cherry picking provision protects TVA's ability to serve customers**
- **Favorable rate-setting mechanisms allow recovery of costs in real time**
- **Integrated power and non-power activities enable TVA to serve as a steward of TVA's service area**



## Summary Conclusions

### **Lazard has concluded that:**

- **TVA's financial performance from 2014 through fiscal year 2020 has been notably strong when measured against:**
  - TVA's financial performance objectives as set forth in its FY14 Plan
  - Other benchmarks (e.g., the performance of other large utility companies)
- **The public power model and TVA's existing business structure is a reasonable approach to support TVA's mission**
  - TVA has been able to carry out its broader mission with respect to energy, environment and economic development under the public power model
  - Lazard believes that its previous conclusions in the 2014 Strategic Assessment with respect to the benefits and considerations of alternative business models vs. the public power model are still valid today