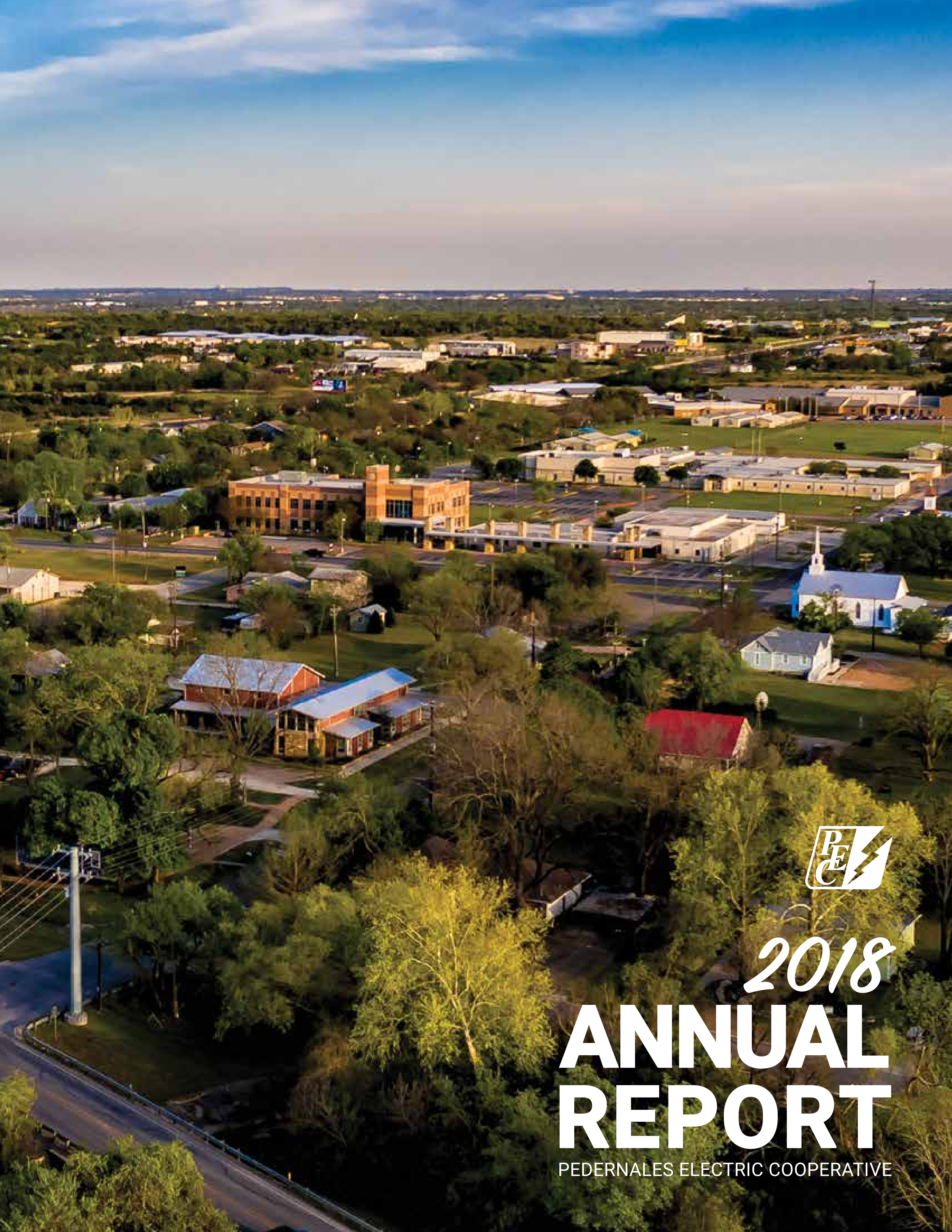

2018 ANNUAL REPORT

PEDERNALES ELECTRIC COOPERATIVE

Message from the Board President

Paul Graf
President
District 6 Director

In 2018, PEC celebrated 80 years of serving the Texas Hill Country. And what a year it was! The cooperative experienced record growth, maintained competitive rates, and continued to strengthen its partnerships and reliability.

2018 also marked the first full year for CEO Julie C. Parsley, who joined PEC in December 2017. Julie's deep understanding of Texas regulation, laws, and the Central Texas culture helped set the foundation for her success — and the board couldn't be more thrilled that she chose PEC. Julie has already made an incredible impact on the cooperative — from realigning teams and departments to better serve the membership, to creating a culture of safety and improving reliability.

We started 2018 with just more than 300,000 accounts and grew by more than 14,500 over the year. This marked a 4.9% growth rate for the third consecutive year — and we don't see this slowing down anytime soon. Additionally, we managed this record growth while keeping your rates competitive, because it is our goal to deliver high-quality service at a great value. We're proud our members pay less than the average Texan for their power (we also beat nationwide averages), so that we can continue to save you, our members, money each and every day.

Furthermore, we know it's increasingly important to remain reliable, so we've invested in and improved our infrastructure to bring you greater reliability than ever. Our reliability metrics are nearly the best in the nation, and we continue to see year-over-year improvement. We reduced the annual average outage time per account to just 54 minutes in 2018. And we are committed to continue to improve our reliability for our membership.

This commitment can also be seen in the cooperative's financial strength. In December, we distributed nearly $11.9 million in capital credits, raising our lifetime distribution to almost $118 million since 2007. This fiscal responsibility resulted in Fitch Ratings confirming our AA- bond credit rating.

There is certainly a lot to celebrate, but none of our success would be possible without our employees, members, and communities. Thank you for your continued support! As the largest electric cooperative in the nation, it is our responsibility to manage our growth strategically and responsibly, and for you to be assured that we will.

Message from the CEO

Julie C. Parsley
Chief Executive Officer

Looking back at 2018, I am filled with pride to have led this cooperative through another year of record growth. It was truly a hallmark year for PEC.

As one of the most popular regions in the country, Central Texas is home to some of the fastest growing counties and cities in the state and nation. At the end of 2018, we served approximately one million consumers across our 8,100 square miles, and our crews set nearly 56 new meters a day.

This growth is unprecedented, but through it we have remained committed to serving our members.

The Texas Hill Country is very special to all of us who call it home. We work here, raise our families here, and grow our communities with our neighbors. Our membership is the backbone of our organization, and supporting and doing what is best for our communities is ingrained in everything we do.

It is this community-focused attitude that helped some of us get through torrential flooding last fall. Our members in Junction and Marble Falls were patient and resilient when their areas were severely affected by flooded lakes and rivers. And our employees raised money, collected supplies, and donated their time to help clean up the parks and riverbeds. These efforts make me so proud of everything our membership and employees put into this cooperative each and every day.

As a result of all this, PEC received local and national recognition in 2018 with J.D. Power naming us No. 10 in the nation for overall customer satisfaction among all electric utilities, not just cooperatives. National Cooperative Bank also included PEC on its Co-op Top 100 list for the third consecutive year, and we were named the 2018 Best Electrical Company in the Austin American-Statesman's annual Best of the Best Awards.

This recognition from within the industry and beyond demonstrates our commitment to being not just the biggest, but the best electric cooperative in the country. We are here to serve you and help your communities thrive. Together, we are PEC Strong!

Across our service area, we see strong, hardworking, and resilient members.

You give your all to your families and communities, always rising above any obstacle.

Inspired by your drive, we improved our reliability and continued our vision to be a leading cooperative in the country. Members, on average, only experience a power interruption once every 1.5 years with the duration lasting around 54 minutes. Overall, the frequency of outages improved by 6% from 2017.

As a result, the Austin American-Statesman named us Best Electrical Company in its 2018 Best of the Best Awards. And we ranked among the top 10 electric providers in the nation on J.D. Power's list for member satisfaction.

THANK YOU FOR *trusting*

PORTIA MARCHMAN AND KYLE FUNK OF
JOHNSON CITY HAVE BEEN PEC MEMBERS SINCE 2018.

We’ve seen you in your communities helping neighbors and helping strangers.

Whether you take charge or take orders, you lend a helping hand in your community. You never stop caring — and we’ve taken note.

Following your lead and the core cooperative principles, we gave back to our communities to help strengthen the foundation for a brighter future across the Texas Hill Country. Through our Community Grants Program, 11 area nonprofits received more than $32,000. We also awarded $100,000 in scholarships to 28 high school seniors, and sent 10 students to Washington, D.C. Inspired by our members, PEC employees donated more than 560 hours of their time serving our communities through volunteer work and gave nearly $270,000 to 262 local charities.

THANK YOU FOR *inspiring*

US.

KAITLYN ARVESEN, 2017 PEC SCHOLARSHIP RECIPIENT AND SOPHOMORE AT THE UNIVERSITY OF TEXAS AT AUSTIN. HER PARENTS, RALPH AND CATHY ARVESEN OF ROUND MOUNTAIN, HAVE BEEN PEC MEMBERS SINCE 1994.

ANDY CARSON, OWNER OF CACTUS CANYON QUARRIES IN MARBLE FALLS, HAS BEEN A PEC MEMBER SINCE 1972.

THANK YOU FOR *partnering* WITH US.

Our roots are planted in a partnership with our members, more than 80 years strong.

Together, we paved the way to a bright future for the Texas Hill Country. And today, we shine because of it.

By working together, much like our members did in 1938, we powered through historic growth, reaching more than 314,500 accounts in 2018. And your commitment makes it possible for us to provide some of the lowest rates in Texas and the nation. In fact, PEC members currently enjoy a residential rate that is more than 10% lower than the average rate available to Texans in competitive areas.*

We're PEC Proud of our rates, and are committed to serving you through unprecedented growth. We are stronger than ever and remain true to our promise: to deliver safe, low-cost, and reliable power.

*Source: Average obtained from the Public Utility Commission of Texas, puc.texas.gov/industry/electric/rates.

Board of Directors

Milton Rister
District 1 Director

Emily Pataki
District 2 Director &
Secretary-Treasurer

Randy R. Klaus
District 3 Director

Jim Powers
District 4 Director &
Vice President

James Oakley
District 5 Director

Paul Graf
District 6 Director &
President

Amy Lea SJ Akers
District 7 Director

Together, we are **PEC Strong.**

And alongside you, we look forward to carrying on our mission — to provide safe, reliable, and affordable power for generations to come.

Since 1938, Pedernales Electric Cooperative has served its members, supported its communities, and helped extend electric service throughout the Texas Hill Country. Photo taken in Leander, Texas.

PEDERNALES ELECTRIC COOPERATIVE

2018 Financial Report

PEDERNALES ELECTRIC COOPERATIVE, INC.

JOHNSON CITY, TEXAS

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
LUBBOCK, TEXAS

PEDERNALES ELECTRIC COOPERATIVE, INC.

JOHNSON CITY, TEXAS

FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

AND

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

PEDERNALES ELECTRIC COOPERATIVE, INC.
JOHNSON CITY, TEXAS

FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

TABLE OF CONTENTS

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
PHONE: (806) 747-3806
FAX: (806) 747-3815
8215 NASHVILLE AVENUE
LUBBOCK, TEXAS 79423-1954

Independent Auditor's Report

Board of Directors
Pedernales Electric Cooperative, Inc.
Johnson City, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of Pedernales Electric Cooperative, Inc. (the Cooperative), which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of income, comprehensive income, and patronage capital, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pedernales Electric Cooperative, Inc. as of December 31, 2018 and 2017, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

April 4, 2019

PEDERNALES ELECTRIC COOPERATIVE, INC.

BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

ASSETS

	December 31, 2018	December 31, 2017
UTILITY PLANT AT COST		
Utility Plant in Service	$ 1,784,158,237	$ 1,664,277,364
Construction Work in Progress	63,244,834	86,569,719
	$ 1,847,403,071	$ 1,750,847,083
Less: Accumulated Provision for Depreciation	298,206,899	288,182,437
	$ 1,549,196,172	$ 1,462,664,646
OTHER PROPERTY AND INVESTMENTS - AT COST OR STATED VALUE		
Investments in Associated Organizations	$ 13,845,105	$ 12,883,443
CURRENT ASSETS		
Cash and Cash Equivalents	$ 2,354,840	$ 21,930,694
Accounts Receivable - Energy (Less allowance for uncollectibles of $590,046 in 2018 and $403,932 in 2017)	22,034,976	20,963,562
Accounts Receivable - Other (Less allowance for uncollectibles of $347,851 in 2018 and $134,173 in 2017)	2,989,733	3,700,291
Accrued Unbilled Revenue	27,772,229	26,364,202
Materials and Supplies Inventory	19,443,659	21,008,122
Other Current and Accrued Assets	3,026,820	2,724,203
Total Current Assets	$ 77,622,257	$ 96,691,074
DEFERRED CHARGES AND OTHER ASSETS	$ 62,351,825	$ 70,071,971
TOTAL ASSETS	$ 1,703,015,359	$ 1,642,311,134

EQUITIES AND LIABILITIES

	2018	2017
EQUITIES		
Memberships	$ 12,784,618	$ 12,165,328
Patronage Capital	458,957,514	436,437,823
Other Equities	215,912,613	189,834,413
Total Equities	$ 687,654,745	$ 638,437,564
LONG-TERM DEBT		
Mortgage Bonds Less Current Maturities and Issuance Costs	$ 283,726,168	$ 297,316,028
CFC Mortgage Notes Less Current Maturities	389,866,921	415,512,960
Chase Notes Less Current Maturities	11,650,000	17,250,000
Line of Credit to be Refinanced	51,500,000	
Total Long-Term Debt	$ 736,743,089	$ 730,078,988
ACCUMULATED PROVISION FOR PENSIONS AND BENEFITS	$ 84,244,772	$ 118,738,568
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	$ 45,101,040	$ 43,546,071
Purchased Power - Payable and Accrued	28,869,914	29,227,106
Accounts Payable - Other	20,009,772	22,208,381
Power Cost Adjustments - Over-Recovered	12,026,220	11,696,801
Tax Payable	11,460,895	10,273,183
Interest Payable	3,648,042	3,790,049
Member Deposits	6,332,614	6,261,953
Other Current and Accrued Liabilities	11,294,402	10,138,868
Total Current Liabilities	$ 138,742,899	$ 137,142,412
DEFERRED CREDITS	$ 55,629,854	$ 17,913,602
TOTAL EQUITIES AND LIABILITIES	$ 1,703,015,359	$ 1,642,311,134

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

STATEMENTS OF INCOME, COMPREHENSIVE INCOME, AND PATRONAGE CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	December 31, 2018	December 31, 2017
OPERATING REVENUES		
Residential	$ 449,967,045	$ 402,911,519
Small Power	68,893,327	63,854,552
Industrial	8,218,953	8,291,167
Large Power	83,322,267	75,676,317
Public Authorities	1,028,840	878,320
Other Operating Revenues	27,875,809	27,362,544
Accrued Unbilled Revenue	1,408,028	2,280,690
Power Cost Adjustment	(2,166,977)	9,515,764
Total Operating Revenues	$ 638,547,292	$ 590,770,873
OPERATING EXPENSES		
Purchased Power	$ 366,572,110	$ 340,336,300
Transmission - Operation	2,059,774	644,178
Transmission - Maintenance	3,138,412	3,689,955
Distribution - Operation	44,469,102	35,702,368
Distribution - Maintenance	16,227,348	15,853,366
Consumer Accounts	25,081,591	23,663,671
Customer Service and Information	3,678,406	3,015,446
Sales	1,673,282	1,769,626
Administrative and General	25,987,568	27,575,134
Depreciation	53,392,308	48,966,498
Taxes	2,062,305	955,323
Other Interest	421,055	405,519
Other Deductions	224,650	56,460
Total Operating Expenses	$ 544,987,911	$ 502,633,844
OPERATING MARGINS - Before Fixed Charges	$ 93,559,381	$ 88,137,029
FIXED CHARGES		
Interest and Amortization on Long-Term Debt	$ 36,342,026	$ 34,463,135
Interest Charged to Construction	(2,140,472)	(2,984,935)
	$ 34,201,554	$ 31,478,200
OPERATING MARGINS - After Fixed Charges	$ 59,357,827	$ 56,658,829
Capital Credits	1,990,368	1,709,064
NET OPERATING MARGINS	$ 61,348,195	$ 58,367,893
NON-OPERATING MARGINS		
Interest and Dividend Income	$ 267,146	$ 226,299
Miscellaneous Non-Operating Income	293,514	190,114
Disposal of Assets	(1,413,057)	1,909,904
	$ (852,397)	$ 2,326,317
NET MARGINS	$ 60,495,798	$ 60,694,210
COMPREHENSIVE INCOME	$ 60,495,798	$ 60,694,210
PATRONAGE CAPITAL - BEGINNING OF YEAR	436,437,823	402,206,786
Patronage Capital Retired	(11,897,906)	(8,358,323)
Transfers to Other Equities	(26,078,201)	(18,104,850)
PATRONAGE CAPITAL - END OF YEAR	$ 458,957,514	$ 436,437,823

See accompanying notes to financial statements.

PEDERNALES ELECTRIC COOPERATIVE, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	December 31, 2018	December 31, 2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Margins	$ 60,495,798	$ 60,694,210
Adjustments to Reconcile Net Margins to Net Cash From Operating Activities		
Depreciation and Amortization Charged to Expense	53,657,448	49,231,638
Provision for Uncollectible Accounts	1,035,622	316,661
Capital Credits	(1,990,368)	(1,709,064)
Deferral/Accrual/Asset Activity for Pension/Post-Retirement Plans	9,460,439	8,745,576
Payments on Post-Retirement Benefits	(2,336,647)	(2,162,324)
Payments to Defined Benefit Plan	(6,277,802)	(9,000,000)
Changes in Assets and Liabilities:		
Accounts Receivable - Net	(1,396,478)	(7,182,465)
Accrued Unbilled Revenue	(1,408,027)	(2,280,691)
Power Cost Adjustments	329,419	(6,608,091)
Materials & Supplies	1,564,463	1,415,349
Prepayments & Other Current Assets	(302,617)	(451,328)
Deferred Charges & Other Assets	7,335,929	345,042
Accrued & Accounts Payable	(2,555,801)	(1,320,576)
Member Deposits	70,661	371,073
Accrued Taxes	1,187,712	1,232,061
Accrued Interest	(142,007)	(75,685)
Other Current Liabilities	1,155,534	907,613
Other Deferred Credits & Liabilities	2,760,683	(1,990,603)
Net Cash From Operating Activities	$ 122,643,961	$ 90,478,396
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Additions to Property, Plant & Equipment	$ (139,923,834)	$ (148,463,124)
Capital Credit Retirements from Associated Organizations	1,028,706	1,004,668
Net Cash From Investing Activities	$ (138,895,128)	$ (147,458,456)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on Long-Term Debt	$ (43,546,070)	$ (39,525,868)
Advances on Long-Term Debt		93,000,000
Net Activity on Line of Credit	51,500,000	
Retirement of Patronage Capital	(11,897,907)	(8,358,323)
Increase in Memberships - Net	619,290	551,195
Net Cash From Financing Activities	$ (3,324,687)	$ 45,667,004
CHANGE IN CASH AND CASH EQUIVALENTS	$ (19,575,854)	$ (11,313,056)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	21,930,694	33,243,750
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 2,354,840	$ 21,930,694
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid During the Year for:		
Interest on Long-Term Debt	$ 36,239,312	$ 34,273,945
Patronage Capital Retired by Noncash Discounting	$ 26,078,200	$ 18,104,850

See accompanying notes to financial statements.

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Pedernales Electric Cooperative, Inc. (the Cooperative) is a non-profit corporation organized to provide electric service at the retail level to primarily residential and commercial accounts in a designated service area. As of December 31, 2018, the Cooperative served approximately 314,855 meters.

Power delivered at retail is purchased wholesale from the Lower Colorado River Authority (LCRA) and other third-party wholesale power suppliers. Any revenues earned in excess of costs incurred are allocated to members of the Cooperative and are reflected as patronage capital on the balance sheet.

Regulatory Accounting

The Cooperative utilizes the Uniform System of Accounts established by the Rural Utilities Service (RUS). In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, Regulated Operations, the Cooperative records certain assets and liabilities in accordance with the economic effects of the rate making process. See Notes 6 and 10 that describe the most significant amounts accounted for under this standard.

Utility Plant

Plant is stated at the original cost of construction which includes the cost of contracted services, direct labor, materials, overhead items and capitalized interest. Contributions from others toward the construction of electric plant are credited to the applicable plant accounts.

When property, which represents a retirement unit, is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expense and other accounts.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and short term investments are considered cash and cash equivalents.

Accounts Receivable

In the normal course of business, the Cooperative recognizes accounts receivable for energy delivered and billed. The Cooperative provides a statement with a due date that will not be less than 16 days after the statement date. Payments not received by the due date are considered delinquent.

The Cooperative provides an allowance for uncollectible accounts to recognize the portion of receivables considered uncollectible. The allowance is estimated based on historical trends, aging of receivables, and a review of potential bad debts. Accounts remaining unpaid 120 days after the due date of the final bill are written off.

Accrued Unbilled Revenue

At December 31, 2018 and 2017, the Cooperative had $27,772,229 and $26,364,202 of unbilled revenue consisting of its revenue accrued for power delivered but not billed and its revenue accrued attributable to purchased power.

Materials and Supplies Inventory

Materials and supplies inventories are valued at average unit cost.

Electric Revenues

The Cooperative records electric revenues as billed to customers on a monthly basis. Revenue is accrued for power delivered but not billed at the end of each month.

The Cooperative's tariffs for electric service include adjustment clauses under which billings to customers are adjusted to reflect changes in the cost of purchased power. In order to match power cost and related revenues, these amounts to be billed to consumers in subsequent periods are included with the revenue accrual described above.

Federal Income Taxes

The Cooperative is exempt from federal income taxes under Section 501(c)(12) of the Internal Revenue Code. More than 85% of the gross income is collected from members.

The Cooperative follows the “uncertain tax positions” provisions of accounting principles generally accepted in the United States of America. The primary tax position of the Cooperative is its filing status as a tax exempt entity. The Cooperative determined that it is more likely than not that its tax positions will be sustained upon examination by the Internal Revenue Service (IRS) and that all tax benefits are likely to be realized upon settlement with taxing authorities.

The Cooperative files income tax returns in the U.S. federal jurisdiction. The Cooperative is no longer subject to examinations by federal taxing authorities for years before 2015. In 2018 and 2017, the Cooperative did not incur tax related interest or penalties.

Group Concentration of Credit Risk

The Cooperative's headquarters facility is located in Johnson City, Texas. The service area extends into 24 counties in the Central Texas region. The Cooperative records a receivable for electric revenues as billed on a monthly basis. The Cooperative may require a deposit from new members upon connection, which is applied to unpaid bills and fees in the event of default. The deposit accrues interest annually and is returned to residential accounts along with accrued interest after one year of prompt payments. As of December 31, 2018 and 2017, deposits on hand totaled $6,332,614 and $6,261,953, respectively.

The Cooperative maintains its cash balances in institutions insured by the Federal Deposit Insurance Corporation (FDIC). The cash balances exceeded applicable insurance coverage at times during 2018 and 2017.

Patronage Capital Certificates

Patronage capital from associated organizations is recorded at the stated amount of the certificate.

Pension Benefit Plans and Other Post-Retirement Benefits

The Cooperative has a defined benefit pension plan (the Plan) for employees meeting eligibility requirements. In 2005, the Plan was amended to close entry to new participants after January 1, 2006. The benefit is based on years of service and the average of the employee's highest 36 months of compensation. The Cooperative also has a defined contribution (401(k) Plan) for employees eligible to participate.

The Cooperative also sponsors a health care plan for retirees who satisfy eligibility requirements. The cost of the Cooperative's obligation is actuarially determined based on certain weighted-average assumptions.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Comparative Financial Information

Certain amounts in the prior period financial statements have been reclassified in order to conform to current period presentation.

2. Assets Pledged

Substantially all assets are pledged as security for the long-term debt due to Bank of New York (BONY) and National Rural Utilities Cooperative Finance Corporation (CFC).

3. Utility Plant

The major classes of utility plant are as follows:

	December 31, 2018	December 31, 2017
Transmission Plant	$ 108,110,511	$ 101,597,553
Distribution Plant	1,479,943,124	1,405,044,718
General Plant	196,104,602	157,635,093
Total Utility Plant in Service	$ 1,784,158,237	$ 1,664,277,364
Construction Work in Progress	63,244,834	86,569,719
Total Utility Plant	$ 1,847,403,071	$ 1,750,847,083

Provision for depreciation of utility plant is computed using straight-line rates as follows:

	2018	2017
Transmission Plant	1.74% - 2.02%	1.74% - 2.02%
Distribution Plant	1.85% - 20.00%	1.85% - 20.00%
General Plant	2.38% - 20.00%	2.38% - 20.00%

Depreciation for the years ended December 31, 2018 and 2017, was $56,459,568 and $52,019,851, respectively, of which $53,392,308 and $48,966,498 was charged to depreciation expense and $3,067,260 and $3,053,353 was allocated to other accounts.

4. Investments in Associated Organizations

Investments in associated organizations consisted of:

	December 31, 2018	December 31, 2017
CFC		
Capital Term Certificates	$ 4,887,296	$ 4,887,296
Patronage Capital	5,359,813	4,645,336
Texas Electric Cooperative		
Patronage Capital	2,993,746	2,869,701
Other	604,250	481,110
	$ 13,845,105	$ 12,883,443

5. Materials and Supplies Inventory

Materials and supplies inventories consist of construction materials and supplies. The ending balances for materials and supplies at December 31, 2018 and 2017 were $19,443,659 and $21,008,122, respectively.

6. Deferred Charges and Other Assets

Deferred charges and other assets included the following:

	December 31, 2018	December 31, 2017
Deferred Charge - Defined Benefit Plan	$ 60,663,121	$ 61,047,338
Debt Application Costs		75,045
Regulatory Asset - LCRA FPCRF	1,270,911	1,161,535
Regulatory Asset - GIS Inventory		5,298,646
Regulatory Asset - TCOS Under-Recovery		1,820,938
LCRA Radio Services	417,793	668,469
	$ 62,351,825	$ 70,071,971

The Cooperative recognizes a deferred charge for the portion of its pension and other post-retirement benefit plans that has not been recognized as a component of net periodic pension and other post-retirement benefit costs. Accordingly, no amounts have been recorded in other comprehensive income. The unrecognized portion is being amortized into pension and other post-retirement benefit costs over the average future service of current active plan participants expected to receive benefits (see Note 13).

The LCRA Fuel & Power Cost Recovery Factor (FPCRF) represents the amount that the Cooperative will be billed by LCRA in future periods for electricity previously purchased. Since this amount will be collected from members in the future through the power cost adjustment (PCA), it is classified as a regulatory asset. A corresponding liability is also recorded for the same amount.

The GIS Inventory regulatory asset represents the deferral of costs incurred by the Cooperative in performing a GPS survey and field inventory of the transmission and distribution system. The deferral of the cost through the ratemaking process was approved by the Cooperative's Board of Directors and will be recovered over a period of up to 15 years. Amortization in 2018 and 2017 was $5,298,646 and $441,554, respectively. This was fully amortized in the current year.

The TCOS under-recovery represents the TCOS component of power cost not yet recovered from customers.

The Cooperative has an agreement in place to utilize LCRA's trunked radio system in the Junction district. The associated costs were paid upon initiation of the agreement. The costs have been capitalized and are being amortized over the contract term, which ends in August 2020.

7. Patronage Capital and Other Equities

Patronage capital represents the Cooperative's accumulated retained net margins that have been allocated annually to its members. Distributions to members are made at the discretion of the Board of Directors in accordance with the bylaws, subject to the covenants contained in the long-term debt agreements.

The loan agreements contain provisions that must be met for the Cooperative to make patronage capital retirements. These provisions include maintaining debt service coverage ratios of 1.15 for the BONY bonds and 1.35 for CFC debt. The Cooperative is in compliance with these provisions at December 31, 2018 and 2017.

Under certain circumstances, the Board of Directors may choose to retire patronage capital earlier than the Cooperative's current approximate 30 year retirement schedule. In these instances, the Cooperative retires and pays the net present value of patronage capital to a member or former member before the time the Cooperative anticipates normally retiring and paying patronage capital.

Patronage capital totaling $11,897,906 and $8,358,323 was distributed to members during 2018 and 2017, respectively.

Patronage capital assigned and assignable at December 31, 2018 and 2017, is as follows:

	December 31, 2018	December 31, 2017
Assigned to Date	$ 705,801,339	$ 647,387,778
Assignable	86,859,651	84,777,415
	$ 792,660,990	$ 732,165,193
Less: Retirements to Date	117,790,863	105,892,957
Less: Discounted Patronage Capital to Permanent Equity	215,912,613	189,834,413
	$ 458,957,514	$ 436,437,823

The Cooperative's bylaws provide that amounts received by the Cooperative in excess of costs and expenses shall, insofar as permitted by law, (a) be used to offset any losses incurred during the current or any prior fiscal year and, (b) to the extent not needed for that purpose, be allocated to its members on a patronage basis.

Other equities at December 31, 2018 and 2017, are as follows:

	December 31, 2018	December 31, 2017
Discounted Capital Credits	$ 215,912,613	$ 189,834,413

8. Long-Term Debt

At December 31, 2018 and 2017, long-term debt consisted of the following:

	December 31, 2018	December 31, 2017
First Mortgage Bonds, 2002 Series A; 5.952%; due 2022 Interest Payable Semi-Annually on May 15 and November 15;	$ 60,535,000	$ 73,625,000
First Mortgage Bonds, 2002 Series A; 6.202%; due 2032 Interest Payable Semi-Annually on May 15 and November 15; Principal Payments Begin 2023	239,500,000	239,500,000
CFC Loan; 3.85%; due 2042 and 2043 Interest and Principal Payable Quarterly Principal Payments Began 2012	202,024,399	207,086,105
CFC Loan; 3.95%; due 2045 Interest and Principal Payable Quarterly Principal Payments Began 2016	23,714,486	24,198,098
CFC Loan; 2.75%; due 2020 Interest and Principal Payable Quarterly Principal Payments Began 2016	34,171,091	50,566,812
CFC Loan; 3.80%; due 2046 Interest and Principal Payable Quarterly Principal Payments Began 2017	76,978,910	78,518,016
CFC Loan; 4.15%; due 2047 Interest and Principal Payable Quarterly Principal Payments Begin 2018	78,624,075	80,000,000
Chase Loan; 2.50%; due 2021 Interest and Principal Payable Quarterly Principal Payments Began 2016	7,500,000	10,500,000
Chase Loan; 3.80%; due 2022 Interest and Principal Payable Quarterly Principal Payments Began 2017	9,750,000	12,350,000
Less: Bond Issue Costs	(2,453,832)	(2,718,972)
	$ 730,344,129	$ 773,625,059
Less: Current Maturities	45,101,040	43,546,071
Total Long-Term Debt	$ 685,243,089	$ 730,078,988

The Cooperative has $6,800,000 available on long-term loan commitments from CFC. These loans are available for drawdown through 2019. Subsequent to year end, the Cooperative has $100,000,000 available on a new long-term loan commitment from CFC.

The Cooperative has $100,000,000 available on long-term loan commitments from CoBank.

Annual maturities of long-term debt for the next five years and thereafter are as follows:

2019	$ 45,101,036
2020	46,742,230
2021	29,143,811
2022	26,339,511
2023	28,243,077
Thereafter	557,228,296

9. Short-Term Borrowing

The Cooperative has a perpetual line of credit at a variable interest rate with CFC not to exceed $100,000,000. At December 31, 2018 and 2017, the Cooperative had $51,500,000 and $0, respectively, outstanding on this line of credit. The line of credit agreement requires the Cooperative to pay down the balance to zero annually and automatically renews unless either party gives a 90 day notice. Pursuant to the Cooperative's utilization of long-term funds to repay these amounts $51,500,000 is classified as long-term debt on the balance sheet at December 31, 2018.

The Cooperative has a line of credit at a variable interest rate with CoBank not to exceed $80,000,000. There was no balance outstanding at December 31, 2018 and 2017.

10. Deferred Credits

Deferred credits included the following:

	December 31, 2018	December 31, 2017
Patronage Capital - Pre-Escheat	$ 8,177,069	$ 7,974,828
Regulatory Liability - LCRA FPCRF	1,270,911	1,161,535
Regulatory Liability - TCOS Over-Recovery	2,449,066	
Post-Retirement Medical Benefits Deferred Credit	43,732,808	8,777,239
	$ 55,629,854	$ 17,913,602

The patronage capital pre-escheat component represents unclaimed patronage capital checks that do not meet escheat criterion. The liability is recorded as unclaimed patronage capital as the checks are voided. As the funds are claimed or reach escheat status, the liability is reduced.

During 2018 and 2017, the Cooperative realized a gain for post-retirement medical benefits. The Cooperative recognized a deferred credit for the net amount of the unrecognized gain (see Note 14). Accordingly, no amounts have been recorded in other comprehensive income.

The TCOS over-recovery represents the TCOS component of power cost already recovered from customers.

11. LCRA Fuel & Power Cost Recovery Factor (FPCRF)

The Fuel and Power Cost Recovery Factor represents over or under-recovered cost adjustments for electricity purchased from LCRA. The FPCRF as of December 31, 2018 represents an under-recovery by LCRA of $1,270,911, which is classified as a deferred credit on the balance sheet and is payable to LCRA. The FPCRF as of December 31, 2017 represents an over-recovery by LCRA of $1,161,535, which is classified as a deferred charge on the balance sheet and is receivable from LCRA.

12. Commitments and Contingencies

Power Supply Contracts

The Cooperative entered into contracts for the purchase and delivery of electric energy to satisfy its electric energy requirements. In 2018 and 2017, the Cooperative purchased energy from the Lower Colorado River Authority (LCRA) and other third party wholesale power suppliers. LCRA was the primary wholesale electric energy supplier, while the other suppliers provided electric energy to serve a portion of the electric energy requirements for the Cooperative's delivery points within LCRA's service territory and the full electric energy requirements for delivery points outside of LCRA's service territory. All of the electric energy purchased by the Cooperative is procured through term contracts of varying durations. As these terms expire, they may or may not be replaced with new agreements.

Transmission Lease Contracts

LCRA leases and operates certain transmission facilities and equipment owned by the Cooperative. Payments for the leased facilities vary from year to year and are based on the original cost of the facilities, adjusted for depreciation, and are updated annually to reflect additions, retirements and depreciation. The terms of the lease are perpetual, but may be terminated by LCRA or the Cooperative upon five years written notice. The Cooperative's transmission lease revenues totaled $5,291,822 and $5,357,862 in 2018 and 2017, respectively.

Litigation

The Cooperative may be involved in various claims and litigation arising in the normal course of business. Although management is unable to predict the outcome of such proceedings, management and the Cooperative's legal counsel do not believe that the resolution of any claims or litigation involving the Cooperative will have a material adverse effect on the Cooperative's results of operations and financial condition.

13. Pension Benefits

The Cooperative has a defined benefit plan covering eligible employees. The cost of the plan is determined by an independent actuary and is funded in amounts sufficient to meet the minimum funding requirements under applicable regulations.

Contributions paid to the defined benefit plan for the years ended December 31, 2018 and 2017, were $6,277,802 and $9,000,000, respectively.

The measurement date used for the current valuation is December 31, 2018.

The following weighted-average assumptions were used to develop the accumulated post-retirement benefit obligation for 2018 and 2017:

	2018	2017
Discount Rate	4.25%	3.60%
Rate of Compensation Increase	4.00%	4.27%

The following weighted-average assumptions were used to determine the net benefit cost for 2018 and 2017:

	2018	2017
Discount Rate	3.60%	4.15%
Rate of Compensation Increase	4.27%	4.84%
Expected Long-Term Return on Plan Assets	6.50%	6.50%

Amounts recognized in the Cooperative's financial statements and funded status of the plan are as follows:

	December 31, 2018	December 31, 2017
I) Net Periodic Benefit Cost		
Service Cost	$ 5,575,691	$ 5,461,578
Interest Cost	9,004,454	9,190,158
Amortization	5,508,323	5,035,078
Return on Assets	(12,561,466)	(10,994,103)
	$ 7,527,002	$ 8,692,711
II) Projected Benefit Obligation (PBO) Reconciliation:		
PBO Balance at Beginning of Year	$ 249,963,880	$ 225,456,075
Actuarial (Gain)/Loss	(19,419,684)	17,724,155
Interest Cost/Service Cost	14,580,145	14,651,736
Benefits Paid	(8,295,665)	(7,868,086)
Projected Benefit Obligation at Year End	$ 236,828,676	$ 249,963,880
III) Reconciliation of Funded Status		
Projected Benefit Obligation	$ 236,828,676	$ 249,963,880
Fair Value of Assets	182,670,446	196,670,633
Funded Status at Year End	$ (54,158,230)	$ (53,293,247)
IV) Deferred Charge		
Actuarial Loss - Beginning of Year	$ 61,047,338	$ 64,183,498
Amortization of Loss/Remeasurement	(5,508,323)	(5,035,078)
Actuarial Loss	5,124,106	1,898,918
Deferred Charge at Year End	$ 60,663,121	$ 61,047,338

The accumulated benefit obligation for the plan was $212,033,728 and $221,754,888 at December 31, 2018 and 2017, respectively.

Plan Asset Information

Information related to fair value hierarchy measurements are disclosed in Note 16. The defined benefit plan asset fair value measurements are substantially Level 1.

Fair value of plan assets at December 31, 2018 and 2017 and asset allocation is as follows:

	December 31, 2018	December 31, 2017
Cash and Cash Equivalents	$ 1,721,743	$ 3,924,361
Government Agencies, Bonds and Notes	89,088,987	70,931,557
Mutual Funds	72,188,478	103,517,691
Other	19,671,238	18,297,024
Total	$ 182,670,446	$ 196,670,633

	December 31, 2018	December 31, 2017
Mutual Funds and Equity Securities	40%	53%
Debt Securities	49%	36%
Other	11%	11%
Total	100%	100%

Benefit payments for the next ten years are estimated as follows:

2019	$ 8,996,843
2020	9,510,352
2021	10,026,933
2022	10,572,400
2023	11,084,567
2024-2028	63,653,393

The estimated 2019 plan year minimum required contribution is $9,000,000.

The Cooperative has a defined contribution plan (401(k) plan) for employees that are eligible to participate. For employees that are also eligible to participate in the defined benefit plan, the maximum contribution is six percent of the employee's base annual salary. For employees not eligible for the defined benefit plan, the 401(k) plan contribution cost is a maximum of ten percent of the employee's base annual salary. These costs are funded each pay period as accrued. The Cooperative's contributions to the 401(k) plan (net of forfeitures) were $4,464,994 and $4,170,967 in 2018 and 2017, respectively.

14. Post-Retirement Benefits Other than Pensions

The Cooperative provides post-retirement medical benefits for eligible employees through a plan with a third-party insurance provider. For purposes of this statement, the written plan in effect is the substantive plan and is considered a defined benefit plan. The Cooperative contributes varying amounts dependent on retirement date, age, and years of service. As of August 2018, the plan is closed to new retired participants not currently receiving benefits under the plan.

Benefits are paid on behalf of retirees and are a function of medical insurance costs and number of retirees. Benefits paid (excluding reimbursements) for the years ended December 31, 2018 and 2017, were $2,636,137 and $2,468,105, respectively. The Cooperative's policy for contributions is to contribute the amount of the current benefits in that year.

The measurement date used for the current valuation is December 31, 2018.

The weighted-average discount rate used to develop the accumulated post-retirement benefit obligation for the years ended December 31, 2018 and 2017, were 4.25% and 3.60%, respectively.

Amounts recognized in the Cooperative's financial statements and funded status of the plan are as follows:

	December 31, 2018	December 31, 2017
I) Net Post-Retirement Benefit Cost		
Service Cost	$ 293,102	$ 472,659
Interest Cost	1,780,054	2,036,045
Amortization	(139,719)	(2,455,339)
	$ 1,933,437	$ 53,365
II) Accumulated Post-Retirement Benefit Obligation (APBO) Reconciliation:		
APBO Balance at Beginning of Year	$ 65,445,321	$ 52,539,738
Actuarial (Gain)/Loss	(2,028,526)	12,559,203
Plan Amendment	(33,066,762)	
Interest Cost / Service Cost	2,073,156	2,508,704
Employer Contributions Net of Participant Amounts	(2,336,647)	(2,162,324)
Net Post-Retirement Benefit Liability at Year End	$ 30,086,542	$ 65,445,321
III) Reconciliation of Funded Status		
APBO	$ 30,086,542	$ 65,445,321
Accrued Post-Retirement Benefit Cost	$ 30,086,542	$ 65,445,321
IV) Deferred Credit		
Actuarial Gain - Beginning of Year	$ (8,777,239)	$ (23,791,781)
Amortization	139,719	2,455,339
Plan Amendment	(33,066,762)	
Current Year Net (Gain)/Loss	(2,028,526)	12,559,203
Deferred Credit at Year End	$ (43,732,808)	$ (8,777,239)

The estimated actuarial amount for the post-retirement medical benefit plan that will be amortized into net post-retirement benefit cost over the next fiscal year is expected to be a gain of $2,559,657.

The Cooperative has not funded any plan assets as of December 31, 2018 or 2017.

Estimated future benefit payments for the next ten years are as follows:

2019	$	2,388,815
2020		2,300,042
2021		2,285,210
2022		2,168,185
2023		2,123,456
2024-2028		9,453,535

15. Recently Issued Accounting Pronouncements

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The new standard is effective for nonpublic entities for fiscal years beginning after December 15, 2019. The Cooperative is evaluating the impact of the new standard on the financial statements.

16. Disclosures About Fair Value of Financial Instruments

Many of the Cooperative's financial instruments lack an available market with similar terms, conditions, and maturities as those reflected in the carrying amount recorded. Accordingly, significant assumptions, estimations, and present value calculations were used for purposes of this disclosure.

Estimated Fair Value has been determined by calculating the present value of financial instruments using the best data available.

Fair Value for some amounts carried on the financial statements has not been calculated for the following reasons:

Patronage Capital from Associated Organizations – The right to receive cash is an inherent component of a financial instrument. The Cooperative holds no right to receive cash since any payments are at the discretion of the governing body for the associated organizations. As such, Patronage Capital from Associated Organizations are not considered financial instruments.

NOTES TO FINANCIAL STATEMENTS

CFC Capital Term Certificates and Member Capital Securities – It is not practicable to estimate fair value for these financial instruments given the lack of a market and their long holding period. Relevant information with respect to these is as follows:

	AMOUNT	INTEREST RATE	MATURITY
$	960,968	3.00%	2020-2030
	1,715,690	0.00%	2043
	2,210,638	5.00%	2070-2080

Cash and Short-Term Investments - The recorded book value approximates fair value given the short period to maturity.

Long-Term Debt - Estimated by computing the present value by individual note to maturity, using currently quoted or offered rates for similar issues of debt. The year-end CFC fixed interest rate for long-term debt was used in the calculation for all fixed rate long-term debt. These are the only financial instruments of the Cooperative that have a difference in Fair Value and Carrying Value.

The carrying values of the Cooperative's financial instruments and debt and the estimated fair values are as follows:

	December 31, 2018		December 31, 2017	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Assets:				
Cash and Cash Equivalents	$ 2,354,840	$ 2,354,840	$ 21,930,694	$ 21,930,694
Liabilities:				
Long-Term Debt	$ 732,797,962	$ 669,942,068	$ 776,344,031	$ 733,716,462

Fair Value Hierarchy

The Fair Value Measurements Topic of the FASB Accounting Standards Codification establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Cooperative has the ability to access at the measurement date.

Level 2 - inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - inputs are unobservable inputs for the asset or liability.

Long-Term Debt valuations are considered Level 2.

PEDERNALES ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

17. Subsequent Events

The Cooperative has evaluated subsequent events through April 4, 2019, the date which the financial statements were available to be issued.

COMPLIANCE SECTION

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS

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LETTER TO BOARD OF DIRECTORS REGARDING POLICIES CONCERNING AUDITS OF CFC BORROWERS

Board of Directors
Pedernales Electric Cooperative, Inc.
Johnson City, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheets of Pedernales Electric Cooperative, Inc. (the Cooperative) as of December 31, 2018 and 2017, and the related statements of income and patronage capital, and cash flows for the years ended, and have issued our report thereon dated April 4, 2019.

In connection with our audit, nothing came to our attention that caused us to believe that the Cooperative failed to comply with the terms of Article V of the National Rural Utilities Cooperative Finance Corporation Loan Agreement insofar as they relate to accounting matters. However, our audits were not directed primarily toward obtaining knowledge of such incompliance.

This report is intended solely for the information and use of the Boards of Directors and management of Pedernales Electric Cooperative, Inc. and the National Rural Utilities Cooperative Finance Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Bolinger, Segars, Gilbert & Moss LLP

Certified Public Accountants

Lubbock, Texas

April 4, 2019

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