

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

Associated Electric Cooperative, Inc. (Associated) is pleased to present the enclosed interim financial statements, which include balance sheets, statements of revenues and expenses and statements of cash flows as of, or for the periods ended March 31, 2009 and 2008. The discussion below is not meant to be comprehensive but rather to identify significant aspects in the current quarter and year-to-date performance of Associated.

### **Overview**

Associated's earnings for the three and twelve month periods ended March 31, 2009 were \$14.0 million and \$105.8 million, an increase of \$48.1 million and \$142.9 million, respectively, as compared to the same periods a year earlier. The increase in earnings for these periods is primarily the result of an increase in member revenue and a decrease in the cost to provide energy to members because of increased production from lower-cost coal and hydropower resources and lower natural gas prices. These factors are discussed in more detail in the paragraphs below.

### **Operating Revenues**

Revenue from members for the three and twelve month periods increased 22.4% and 24.2% respectively as compared to the same periods a year earlier due to a 25.3% increase in member rates effective April 1, 2008. The volume of energy sales to members decreased during both the three and twelve month periods, 6.0% and 2.9% respectively. These decreases are largely driven by milder weather in the first quarter 2009 compared to 2008.

Revenue from nonmembers decreased 31.8% for the three month period and increased 9.8% for the twelve month period ended March 31, 2009, when compared to the same periods a year earlier. The first quarter decrease was due to a 47.4% decrease in average market price which was partially offset by a 26.5% increase in sales volume. The increase for the twelve month period was due to a 16.9% increase in sales volume, partially offset by an average market price which was lower than that of the previous year by 4.8%. Market prices have been affected by the significant drop in natural gas fuel prices.

### **Generation Operation**

Generation operations expense decreased 22.8% for the three month period and increased 4.0% for the twelve month period ended March 31, 2009, when compared to the same periods a year earlier. The decrease in the first quarter of 2009 was the result of several factors, including lower energy sales volumes to members, increased production from Associated's low-cost coal fleet and lower natural gas prices. Generation operation expenses increased for the twelve month period due primarily to \$35.9 million in revenue from the sale of emission allowances in the previous year that reduced operations expenses.

### **Purchased Power**

Purchased power expense decreased 42.1% for the three month period and 20.4% for the twelve month period ended March 31, 2009, when compared to the same periods a year earlier. The decrease in purchased power expense for both periods was largely the result of significantly lower market prices. Additionally, during the twelve month period Associated had the opportunity to purchase unusually large volumes of supplemental hydropower energy at a very low cost, thus reducing the average cost of purchased power. Purchases are made only if they result in a savings relative to Associated's owned or contracted generation assets

### **Non Operating Income**

Interest and dividend income decreased 20.0% for the three month period and 35.8% for the twelve month period ended March 31, 2009, when compared to the same periods a year earlier because of lower interest rates and fewer funds available to invest during these periods.

### **Financial Position:**

Significant changes in the balance sheet at March 31, 2009 as compared to March 31, 2008 include the following:

- Utility plant increased \$269.9 million due primarily to the addition of environmental control equipment at Thomas Hill Energy Center.
- Restricted short-term investments increased \$50.6 million due to movement of deferred revenue funds into investments with shorter maturities.
- Deferred debits increased \$23.0 million due to increases in deferred costs of an interest rate swap agreement, increases in the deferral of certain eligible maintenance costs and deferral of energy efficiency program costs.
- Patronage capital and other equities increased \$94.4 million as a net result of a \$105.8 million net margin during the twelve months ended March 31, 2009, the retirement of \$6.1 million of patronage capital and a \$5.3 million decrease in accumulated other comprehensive income related to gas hedging agreements and post-retirement benefit obligations.
- Long term debt increased \$175.9 million to finance construction of new generation and environmental control equipment.
- Other deferred liabilities increased \$31.1 million due primarily to the deferral of the gain on a sale-leaseback transaction related to some of Associated's rail cars and adjustments made to the liability associated with an interest rate swap agreement.

**Associated Electric Cooperative, Inc.**  
**Balance Sheets**  
**March 31, 2009 and March 31, 2008**  
*(in thousands of dollars)*

	2009	2008
<b>Assets</b>		
Utility plant:		
Electric plant in service	\$ 2,751,112	\$ 2,264,265
Construction work in progress	122,261	339,183
	<u>2,873,373</u>	<u>2,603,448</u>
Less accumulated depreciation	(1,171,671)	(1,119,902)
	<u>1,701,702</u>	<u>1,483,546</u>
Mining property and equipment:		
Land	9,730	10,287
Equipment	20,343	20,361
	<u>30,073</u>	<u>30,648</u>
Less accumulated depreciation and depletion	(19,933)	(19,867)
	<u>10,140</u>	<u>10,781</u>
Other property and investments:		
Nonutility property	7,991	1,112
Net investment in direct financing leases	5,633	5,711
Advanced construction funds	16,889	12,367
Long-term investments	1,337	2,190
	<u>31,850</u>	<u>21,380</u>
Restricted and designated long-term assets:		
Investments in associated organizations, at cost	26,592	23,135
Restricted long-term investments	1,288	1,946
Other Restricted and designated assets	13,123	35,715
	<u>41,002</u>	<u>60,796</u>
Current assets:		
Cash and cash equivalents	66,379	34,072
Restricted short-term investments, at fair value	149,422	98,865
Short-term investments	8,381	19,238
Accounts receivable, net	89,237	74,344
Fuel inventory	48,882	39,784
Materials and supplies inventory	43,415	40,095
Other current assets	9,476	15,254
	<u>415,192</u>	<u>321,652</u>
Deferred debits	75,104	52,069
	<u>75,104</u>	<u>52,069</u>
Total assets	<u>\$ 2,274,989</u>	<u>\$ 1,950,224</u>

The interim financial statements for March 30, 2009, and 2008 are unaudited. In the opinion of management all adjustments (which are normal recurring accruals) necessary for a fair presentation of results for interim periods have been included. The interim financial statements should be read in conjunction with the Notes to the Financial Statements included in the 2008 Annual Report.

**Associated Electric Cooperative, Inc.**  
**Balance Sheets**  
**March 31, 2009 and March 31, 2008**  
*(in thousands of dollars)*

	2009	2008
<b>Capitalization and Liabilities</b>		
Patronage capital and other equities:		
Memberships	\$ 12	\$ 12
Patronage capital	323,359	223,618
Other equities	55,540	55,540
Accumulated other comprehensive income (expense)	(15,063)	(9,730)
	<u>363,848</u>	<u>269,440</u>
Long-term debt, excluding current maturities:		
Federal Financing Bank	697,045	639,313
CoBank	309,865	330,888
National Rural Utilities Cooperative Finance Corporation	119,174	78,407
State Environmental Improvement and Energy Resources Authority (Missouri)	71,550	71,550
Other Long Term Debt	159,337	60,555
Rural Utilities Service	196	577
	<u>1,357,167</u>	<u>1,181,291</u>
Asset Retirement Obligation	15,384	14,761
Accumulated provision for postretirement benefits	<u>30,174</u>	<u>30,926</u>
Current liabilities:		
Payable to member cooperatives	31,659	41,993
Accounts payable	118,675	93,526
Other current and accrued liabilities	29,136	24,930
Current maturities of long-term debt	62,505	58,286
Current portion of Asset Retirement Obligation	1,624	797
	<u>243,598</u>	<u>219,532</u>
Deferred regulatory credits	221,265	221,791
Other deferred liabilities	43,552	12,483
	<u>264,817</u>	<u>234,274</u>
Total capitalization and liabilities	<u>\$ 2,274,989</u>	<u>\$ 1,950,224</u>

The interim financial statements for March 30, 2009, and 2008 are unaudited. In the opinion of management all adjustments (which are normal recurring accruals) necessary for a fair presentation of results for interim periods have been included. The interim financial statements should be read in conjunction with the Notes to the Financial Statements included in the 2008 Annual Report.

**Associated Electric Cooperative, Inc.**  
**Statements of Revenue and Expenses**  
**For the Quarters and Years Ended March 31, 2009 and 2008**

*(in thousands of dollars)*

	Three months ended		Twelve months ended	
	March 31		March 31	
	2009	2008	2009	2008
Operating revenues:				
Members	\$ 212,752	\$ 173,765	\$ 798,188	\$ 642,529
Nonmembers	44,445	65,133	304,881	277,762
	<u>257,198</u>	<u>238,899</u>	<u>1,103,069</u>	<u>920,290</u>
Operating expenses:				
Generation operation	97,004	125,595	377,206	362,712
Contracted generation	47,202	45,263	194,321	175,191
Power purchased	25,204	43,538	134,533	168,945
Generation maintenance	13,579	11,390	62,649	56,902
Transmission	14,815	12,678	57,335	56,428
Administrative and general	11,303	9,109	40,750	35,508
Depreciation and amortization	20,052	16,258	69,457	62,027
Taxes	910	692	2,577	2,106
Accretion of asset retirement obligations	216	169	967	841
	<u>230,286</u>	<u>264,693</u>	<u>939,794</u>	<u>920,660</u>
Operating margin before interest expense	<u>26,911</u>	<u>(25,795)</u>	<u>163,276</u>	<u>(370)</u>
Interest expense:				
Interest on long-term debt	19,263	16,806	78,313	65,231
Less interest capitalized	(1,003)	(2,256)	(16,921)	(8,504)
	<u>18,260</u>	<u>14,550</u>	<u>61,392</u>	<u>56,727</u>
Operating margin	<u>8,651</u>	<u>(40,345)</u>	<u>101,884</u>	<u>(57,097)</u>
Nonoperating:				
Interest and dividend income	5,424	6,777	14,880	23,168
Interest expense	(60)	(505)	(1,038)	(3,138)
Loss on termination of power plant project	-	-	(9,918)	-
Total nonoperating	<u>5,364</u>	<u>6,273</u>	<u>3,924</u>	<u>20,030</u>
Net margin (loss)	<u>14,015</u>	<u>\$ (34,072)</u>	<u>105,808</u>	<u>\$ (37,067)</u>

The interim financial statements for March 31, 2009, and 2008 are unaudited. In the opinion of management all adjustments (which are normal recurring accruals) necessary for a fair presentation of results for interim periods have been included. The interim financial statements should be read in conjunction with the Notes to the Financial Statements included in the 2008 Annual Report.

**Associated Electric Cooperative Inc.**  
**Statements of Cash Flows**  
**For the Quarters and Years Ended March 31, 2009 and 2008**  
*(dollars in thousands)*

	Three months ended		Twelve months ended	
	March 31		March 31	
	2009	2008	2009	2008
Cash flows from operating activities:				
Net margin(loss)	\$ 14,015	\$ (34,072)	\$ 105,808	\$ (37,067)
Reconciliation of net margin to net cash provided by operating activities:				
Depreciation and amortization	21,311	17,747	74,962	68,181
Amortization of loan expenses and other	591	565	2,069	1,008
Increase (decrease) in deferred debits, net	2,975	(4,221)	(25,103)	(14,306)
Change in asset retirement obligation	266	115	623	(3,832)
Increase (decrease) in deferred regulatory credits	(2,550)	(2,686)	(526)	(38,287)
Changes in current assets and liabilities:				
Accounts receivable, net	(2,109)	(857)	(14,893)	6,726
Fuel inventories	3,031	(1,737)	(9,098)	(14,226)
Materials and supplies inventories	1,142	(963)	(3,320)	(4,564)
Accounts payable	(20,350)	(40,534)	25,149	36,284
Decrease in mine separation	-	0		(12)
Other current and accrued liabilities	10,425	6,769	5,033	(4,616)
Other operating activities net	(2,042)	4,193	36,094	6,685
Net cash provided (used) by operating activities	<u>26,704</u>	<u>(55,680)</u>	<u>196,798</u>	<u>1,974</u>
Cash flows from investing activities:				
Construction/capital expenditures, net	(42,172)	(27,976)	(293,053)	(291,528)
Sale (purchase) of mine P&E	-	(18)	575	3,240
Sale (Purchase) of investments	(197)	32,833	(28,340)	92,650
Investments in associated organizations , net	623	(3,114)	(3,457)	(2,970)
Direct financing lease proceeds	(19)	31	79	121
Other investing activities, net	(6,076)	328	(3,991)	(9,860)
Net cash used in investing activities	<u>(47,840)</u>	<u>2,085</u>	<u>(328,186)</u>	<u>(208,347)</u>
Cash flows from financing activities:				
Net investments from member cooperatives	(2,225)	(11,381)	(10,334)	(18,810)
Issuance and retirement of long-term debt, net	17,651	11,890	180,095	229,854
Retirement of patronage capital		-	(6,067)	(5,971)
Net cash provided by (used in) financing activities	<u>15,427</u>	<u>509</u>	<u>163,695</u>	<u>205,074</u>
Net increase (decrease) in cash and cash equivalents	<u>\$ (5,709)</u>	<u>\$ (53,086)</u>	<u>\$ 32,307</u>	<u>\$ (1,300)</u>
Cash and cash equivalents, beginning of period	\$ 72,088	\$ 87,158	\$ 34,072	\$ 35,372
Cash and cash equivalents, end of period	<u>\$ 66,379</u>	<u>\$ 34,072</u>	<u>\$ 66,379</u>	<u>\$ 34,072</u>

The interim financial statements for March 31, 2009, and 2008 are unaudited. In the opinion of management all adjustments (which are normal recurring accruals) necessary for a fair presentation of results for interim periods have been included. The interim financial statements should be read in conjunction with the Notes to the Financial Statements included in the 2008 Annual Report.