

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 June 30, 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 six and twelve month periods ended June 30, 2009 were \$42.6 million and \$75.9 million, an increase of \$18.2 million and \$61.3 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 lower natural gas prices. These factors are discussed in more detail in the paragraphs below.

Operating Revenues

Revenue from members for the six and twelve month periods increased 13.1% and 16.6% respectively as compared to the same periods. Member revenue increased for the twelve months ending June 30, 2009 by \$114.8 million due to the rate increases in April 2008 and 2009. The volume of energy sales to members decreased during both the six and twelve month periods, 2.7% and 2.3% respectively. These decreases are driven by the loss of a municipal load, the affects of the energy efficiency program, and the overall economic conditions.

Revenue from nonmembers decreased 41.7% for the six month period and decreased 14.3% for the twelve month period ended June 30, 2009, when compared to the same periods a year earlier. The second quarter decrease in nonmember sales was due to a 49.1% decrease in average market price which was partially offset by a 12.5% increase in sales volume. The decrease for the twelve month period was due to a 25.7% decrease in the average market price which was partially offset by a 17.5% increase in sales volume. The market prices for nonmembers have been affected by the significant drop in natural gas fuel prices.

Generation Operation

Generation operations expense decreased 13.3% for the six month period and increased 5.9% for the twelve month period ended June 30, 2009, when compared to the same periods a year earlier. The decrease in the second 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 42.5% for the six month period and 31.1% for the twelve month period ended June 30, 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 21.0% for the six month period and 31.4% for the twelve month period ended June 30, 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 June 30, 2009 as compared to June 30, 2008 include the following:

- Utility plant increased \$285.6 million due primarily to the addition of environmental control equipment at Thomas Hill Energy Center.
- Construction Work In Progress decreased by \$181.5 million due to the completion of the Thomas Hill SCRs, which were put into service in December 2008.
- Restricted short-term investments increased \$52.7 million primarily due to the reclassification of the GEIF cushion of credit investments.
- Deferred debits increased \$31.4 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, and payments for the Chouteau 2 pipeline.
- Patronage capital and other equities increased \$69.8 million as a net result of a \$75.9 million net margin during the twelve months ended June 30, 2009, the retirement of \$7.1 million of patronage capital and a \$1.1 million decrease in accumulated other comprehensive income related to post-retirement benefit obligations.
- Long term debt increased \$201.7 million primarily due to finance construction of new generation and environmental control equipment.

- Other deferred liabilities increased \$22.5 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
June 30, 2009 and June 30, 2008
(in thousands of dollars)

	2009	2008
Assets		
Utility plant:		
Electric plant in service	\$ 2,765,289	\$ 2,298,149
Construction work in progress	165,254	346,763
	<u>2,930,543</u>	<u>2,644,912</u>
Less accumulated depreciation	(1,193,589)	(1,136,580)
	<u>1,736,954</u>	<u>1,508,333</u>
Mining property and equipment:		
Land	9,533	9,909
Equipment	20,343	20,361
	<u>29,876</u>	<u>30,271</u>
Less accumulated depreciation and depletion	(19,954)	(19,888)
	<u>9,922</u>	<u>10,382</u>
Other property and investments:		
Nonutility property	7,992	5,181
Net investment in direct financing leases	5,546	5,679
Advanced construction funds	16,444	12,448
Long-term investments	1,170	2,322
	<u>31,151</u>	<u>25,630</u>
Restricted and designated long-term assets:		
Investments in associated organizations, at cost	26,584	26,605
Unexpended loan proceeds on deposit	-	-
Restricted long-term investments	11,288	1,946
Other Restricted and designated assets	13,054	47,505
	<u>50,925</u>	<u>76,056</u>
Current assets:		
Cash and cash equivalents	58,116	41,575
Restricted short-term investments, at fair value	148,600	95,911
Short-term investments	7,327	13,088
Accounts receivable, net	117,385	91,853
Fuel inventory	50,340	38,500
Materials and supplies inventory	44,951	41,080
Other current assets	7,021	10,904
	<u>433,740</u>	<u>332,912</u>
Deferred debits	<u>84,608</u>	<u>53,170</u>
	<u>518,348</u>	<u>386,082</u>
	<u>2,347,300</u>	<u>2,006,483</u>
Total assets	\$ 2,347,300	\$ 2,006,483

The interim financial statements for June 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
June 30, 2009 and June 30, 2008
(in thousands of dollars)

	2009	2008
Capitalization and Liabilities		
Patronage capital and other equities:		
Memberships	\$ 12	\$ 12
Patronage capital	344,825	276,023
Other equities	55,540	55,540
Accumulated other comprehensive income (expense)	(7,197)	(8,228)
	<u>393,180</u>	<u>323,346</u>
Long-term debt, excluding current maturities:		
Federal Financing Bank	685,630	689,830
CoBank	375,634	303,912
National Rural Utilities Cooperative Finance Corporation	115,127	76,848
State Environmental Improvement and Energy Resources Authority (Missouri)	71,550	71,550
Other Long Term Debt	156,416	60,155
Rural Utilities Service	46	448
	<u>1,404,404</u>	<u>1,202,743</u>
Mine Separation Costs	-	-
Asset Retirement Obligation	<u>15,547</u>	<u>14,630</u>
Accumulated provision for postretirement benefits	<u>29,495</u>	<u>30,648</u>
Current liabilities:		
Payable to member cooperatives	36,775	52,182
Accounts payable	108,031	72,735
Other current and accrued liabilities	29,501	27,896
Current maturities of long-term debt	74,093	61,246
Current portion of Asset Retirement Obligation	1,714	458
	<u>250,113</u>	<u>214,517</u>
Deferred regulatory credits	220,613	209,187
Other deferred liabilities	33,948	11,411
	<u>254,561</u>	<u>220,598</u>
Total capitalization and liabilities	<u>\$ 2,347,300</u>	<u>\$ 2,006,483</u>

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Associated Electric Cooperative, Inc.
Statements of Revenue and Expenses
For the Quarters and Years Ended June 30, 2009 and 2008

(in thousands of dollars)

	Six months ended		Twelve months ended	
	June 30		June 30	
	2009	2008	2009	2008
Operating revenues:				
Members	\$ 419,724	\$ 370,996	\$ 807,928	\$ 693,083
Nonmembers	96,404	165,452	256,521	299,429
	<u>516,127</u>	<u>536,448</u>	<u>1,064,450</u>	<u>992,512</u>
Operating expenses:				
Generation operation	177,061	204,249	378,609	357,451
Contracted generation	93,777	97,494	190,374	183,927
Power purchased	45,762	79,600	117,320	170,248
Generation maintenance	34,018	22,916	71,562	58,604
Transmission	29,796	25,459	59,535	55,243
Administrative and general	21,751	18,148	42,158	35,619
Depreciation and amortization	40,487	32,533	73,617	63,745
Taxes	1,390	1,125	2,622	2,078
Accretion of asset retirement obligations	432	339	1,013	787
	<u>444,473</u>	<u>481,862</u>	<u>936,810</u>	<u>927,702</u>
Operating margin before interest expense	<u>71,655</u>	<u>54,586</u>	<u>127,640</u>	<u>64,810</u>
Interest expense:				
Interest on long-term debt	39,608	33,415	82,047	66,541
Less interest capitalized	(2,843)	(4,129)	(16,887)	(8,209)
	<u>36,765</u>	<u>29,286</u>	<u>65,161</u>	<u>58,332</u>
Operating margin	<u>34,890</u>	<u>25,300</u>	<u>62,479</u>	<u>6,478</u>
Nonoperating:				
Interest and dividend income	7,806	9,880	14,160	20,627
Interest expense	(97)	(862)	(718)	(2,573)
Loss on termination of power plant project	-	(9,918)	-	(9,918)
Total nonoperating	<u>7,709</u>	<u>(901)</u>	<u>13,442</u>	<u>8,136</u>
Net margin (loss)	<u>\$ 42,599</u>	<u>\$ 24,399</u>	<u>\$ 75,921</u>	<u>\$ 14,614</u>

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Associated Electric Cooperative Inc.
Statements of Cash Flows
For the Quarters and Years Ended June 30, 2009 and 2008
(dollars in thousands)

	Six months ended		Twelve months ended	
	June 30		June 30	
	2009	2008	2009	2008
Cash flows from operating activities:				
Net margin(loss)	\$ 42,599	\$ 24,399	\$ 75,921	\$ 14,614
Reconciliation of net margin to net cash provided by operating activities:				
Depreciation and amortization	43,287	35,918	60,774	70,326
Amortization of loan expenses and other	383	1,000	1,426	721
Increase (decrease) in deferred debits, net	(6,322)	(5,757)	(32,864)	(15,512)
Change in asset retirement obligation	429	(16)	917	(4,135)
Increase (decrease) in deferred regulatory credits	(3,202)	(15,290)	11,426	(48,206)
Changes in current assets and liabilities:				
Accounts receivable, net	(30,257)	(18,366)	(25,532)	(13,340)
Fuel inventories	1,573	(453)	(11,840)	(11,302)
Materials and supplies inventories	(394)	(1,949)	(3,870)	(3,464)
Accounts payable	(30,994)	(61,326)	35,296	(1,992)
Decrease in mine separation	-	()	()	(39)
Other current and accrued liabilities	10,880	9,397	2,860	(4,676)
Other operating activities net	(9,869)	7,192	25,268	15,597
Net cash provided (used) by operating activities	18,112	(25,249)	139,783	(1,408)
Cash flows from investing activities:				
Construction/capital expenditures, net	(99,378)	(70,912)	(289,330)	(262,621)
Sale (purchase) of mine P&E	197	360	394	3,376
Sale (Purchase) of investments	(7,630)	25,879	(28,818)	71,103
Investments in associated organizations , net	632	(6,583)	21	(6,350)
Direct financing lease proceeds	68	63	133	123
Other investing activities, net	1,780	1,816	2,377	(8,360)
Net cash used in investing activities	(104,332)	(49,378)	(315,222)	(202,731)
Cash flows from financing activities:				
Net investments from member cooperatives	2,891	(1,191)	(15,407)	(8,860)
Issuance and retirement of long-term debt, net	76,476	36,302	214,507	87,516
Retirement of patronage capital	(7,119)	(6,067)	(7,119)	(6,067)
Net cash provided by (used in) financing activities	72,248	29,044	191,981	72,589
Net increase (decrease) in cash and cash equivalents	\$ (13,972)	\$ (45,583)	\$ 16,541	\$ (131,549)
Cash and cash equivalents, beginning of period	\$ 72,088	\$ 87,158	\$ 41,575	\$ 173,124
Cash and cash equivalents, end of period	\$ 58,116	\$ 41,575	\$ 58,116	\$ 41,575

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