

Associated Electric Cooperative Inc.

A Touchstone Energy[®] Cooperative 

Financial Statements

For the Quarterly Periods Ended

September 30, 2011 and 2010

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 September 30, 2011 and 2010. 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

Net margin for the three and nine month period ended September 30, 2011 was \$33.0 million and \$79.1 million, respectively, compared to \$26.1 million and \$70.2 million in the same periods of 2010. Total assets at September 30, 2011 were \$2.8 billion, an increase of \$108.9 million over the balance at September 30, 2010. Significant factors contributing to Associated's financial performance for these periods are discussed in detail in the paragraphs below.

Operating Revenues

Revenue from members for the quarter ended September 30, 2011 increased \$10.1 million, or 4.3%, as compared to the third quarter of 2010. Revenue for the nine month period increased \$15.5 million, or 2.3%, over the same period of the prior year. The increase in member revenue for both the three months and nine months ending September 30, 2011 was largely due to an increase in the member energy rate in 2011 as compared to 2010. In 2010, a temporary rate discount was in effect that reduced member revenue for the year by approximately \$50 million. The temporary rate discount in effect for 2011 is less than the 2010 discount and is expected to decrease member revenue by approximately \$30 million. Energy sales volume was 1.2% higher for the third quarter of 2011 as compared to the same period in 2010 and 1.3% lower for the year-to date in 2011. Additionally, the demand revenue from members for the nine months ending September 30, 2011 increased \$7.0 million as compared to the same period last year. The increase in demand revenue is due to a 5% increase in member billing demand.

Revenue from nonmembers increased \$3.7 million, or 6.1%, for the third quarter of 2011 and increased \$3.2 million, or 2.1%, for the nine month period ended September 30, 2011, as compared to the same periods a year earlier. The increase in nonmember revenue for the third quarter was largely due to an increase in energy sales volume of 7.0% as compared to the same quarter in 2010. Additionally, the average sales price was 4.2% higher as compared to the same period of 2010. For the nine month period, the volume of energy sales to nonmembers increased 4.8% and the average sales price increased 3.1%. The increase in non-member revenue for the nine month period was off-set by the capitalization of \$4.7 million in test energy sales generated by the Chouteau 2 and Dell Fuel oil projects.

Purchased Power

Purchased power expense decreased \$7.2 million, or 30.5% for the third quarter of 2011. Purchased power increased \$1.0 million, or 1.3%, for the nine month periods ended September 30, 2011, as compared to the same periods of 2010. The decrease in purchased power for the third quarter of 2011 was largely due to the 38% decrease in interchange energy purchase volume. The decrease in interchange energy purchases was largely due to the increase in gas generation from placing the Chouteau 2 power plant in-service in June 2011. The increase in purchased power expense for the nine months ended September 30, 2011 was due, in part, to Associated's purchase of additional wind energy from a wind farm placed in service in February 2010, which had an increase in energy output of 38.4% as compared to the same period the prior year. Offsetting the increase in wind energy expense, were decreases in interchange purchases and hydro supplemental energy purchase expense.

Depreciation and Amortization

Depreciation and amortization expense increased \$3.1 million or 15.1% for the third quarter of 2011 and increased \$2.4 million or 4.0% for the nine month period ended September 30, 2011 as compared to the same period last year. The increase in depreciation and amortization expense was due to placing \$575.8 million of assets in-service in June of 2011, which included: the Chouteau 2 Power Plant, fuel oil backup capability at Dell, and a turbine overhaul project at the New Madrid 1 facility.

Generation Maintenance

Generation maintenance expense increased by \$3.1 million, or 20.4%, in the third quarter of 2011 and decreased \$4.9 million or 9.2% for the nine months ending September 30, 2011 as compared to the same period in 2010. Maintenance expense for the third quarter of 2011 increased primarily due to placing Chouteau 2 in-service in June of 2011. Maintenance expense for the nine month period ended September 30, 2011 decreased primarily due to a 42% decrease in maintenance expense at the New Madrid 2 facility because of a longer maintenance outage in the first nine months of 2010 as compared to the same period in 2011. Partially offsetting the decrease in maintenance expense at the New Madrid 2 facility, was an increase of 26% in maintenance expense at the gas plant facilities with the addition of the Chouteau 2 plant.

Transmission

Transmission expense increased by \$2.4 million or 10.4% for the third quarter of 2011 and increased \$5.0 million or 15.1% for the nine months ending September 30, 2011 as compared to the same period in 2010. Transmission expense for the third quarter increased due to an increase in purchases of transmission service from others in order to serve members. Transmission expense for the nine months ending September 2011 increased due to a \$2.1 million increase in the operation and maintenance expense of Associated's and its six members' transmission assets and an increase of \$3.0 million for transmission service purchased from others.

Interest Expense

Interest expense on long-term debt increased by \$0.2 million and \$5.2 million, or 0.7% and 8.0% respectively, for the three months and nine months ended September 30, 2011 when compared to the same period in 2010. The increase is due to new borrowings to fund new generation and other capital projects at Associated's existing generating resources. The amount of interest capitalized decreased by \$5.4 million and \$0.4 million, respectively, for the three and nine months ended September 30, 2011 due to placing \$575.8 million of assets in-service in June 2011 for which interest was capitalized during the construction period.

Financial Position:

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

Significant changes in the balance sheet at September 30, 2011 as compared to September 30, 2010 include the following:

- Utility plant increased \$172.0 million due primarily to construction of the new Chouteau 2 Power Plant, turbine projects at New Madrid Power Plant and Thomas Hill Energy Center, and the addition of fuel oil backup capability at Dell Power Plant. In June 2011, Associated placed into service \$575.8 million of assets including the Chouteau 2 Power Plant, fuel oil backup capability at Dell, and a turbine overhaul project at the New Madrid 1 facility.

- Other restricted and designated assets increased by \$101.8 million due to an increase in funds in the RUS cushion of credit.
- Restricted short-term investments decreased by \$56.9 million. This decrease is due to a transfer of investments from short-term investments to the long-term RUS cushion of credit.
- Deferred regulatory debits decreased by \$3.8 million. The decrease is primarily due to a decrease in unrealized losses on gas hedges and interest rate swap of \$1.7 million, which are deferred until such time these losses become realized. Associated also defers major maintenance projects, which are capitalized as incurred and then amortized over a five year period. Major maintenance costs deferred decreased by \$1.5 million.
- Patronage capital and other equities increased \$44.9 million as a net result of: \$54.7 million in net margin, the retirement of \$8.4 million of patronage capital, and \$1.3 million in amortization of the net periodic benefit cost of the UMWA postretirement benefit program.
- Long term debt had a net increase of \$76.7 million. Borrowings from the Federal Financing Bank (FFB) increased, net of principal payments, by \$301.2 million, which was used primarily to fund new generation and other capital expenditures. Offsetting the increase in borrowing from FFB was a decrease in line of credit draws of \$195 million.
- Deferred regulatory credits increased \$10.6 million. In December 2010, \$24 million of member revenue was designated as subject to future refund and a regulatory credit was recorded for this amount. Associated previously deferred revenue for future costs to comply with the 1990 Clean Air Act Amendments (the Act). This deferred regulatory credit is being amortized into income in an amount equal to the amortization of the related costs that have been capitalized to comply with the Act. Between September 30, 2010 and September 30, 2011, \$10.2 million was amortized into revenue. Additionally, unrealized gains on gas hedges decreased \$3.2 million, which are deferred until such time these gains become realized.

Associated Electric Cooperative, Inc.
Statements of Revenue and Expenses

(in thousands)

	Three months ended		Nine months ended	
	September 30		September 30	
	2011	2010	2011	2010
Operating revenues:				
Members	\$243,580	\$233,523	\$693,979	\$678,460
Nonmembers	64,974	61,234	159,493	156,255
	<u>308,554</u>	<u>294,758</u>	<u>853,472</u>	<u>834,715</u>
Operating expenses:				
Generation operation	117,336	117,855	293,439	298,747
Contracted generation	46,932	46,605	146,510	141,670
Power purchased	16,429	23,651	77,447	76,429
Depreciation and amortization	23,479	20,392	63,642	61,210
Generation maintenance	18,262	15,164	48,323	53,194
Transmission	18,225	15,829	52,696	47,735
Administrative and general	14,378	13,715	43,128	41,182
Taxes	912	716	2,001	1,767
Accretion of asset retirement obligations	232	243	713	730
	<u>256,184</u>	<u>254,171</u>	<u>727,899</u>	<u>722,663</u>
Operating margin before interest expense	<u>52,370</u>	<u>40,586</u>	<u>125,573</u>	<u>112,052</u>
Interest Expense:				
Interest on long-term debt	24,064	23,903	70,791	65,574
Less: interest capitalized	(537)	(5,963)	(10,868)	(11,294)
	<u>23,527</u>	<u>17,940</u>	<u>59,924</u>	<u>54,281</u>
Operating margin	<u>28,842</u>	<u>22,646</u>	<u>65,649</u>	<u>57,772</u>
Nonoperating:				
Interest and dividend income	4,243	3,536	13,765	12,601
Interest expense	(68)	(62)	(285)	(156)
Total nonoperating	<u>4,175</u>	<u>3,475</u>	<u>13,480</u>	<u>12,445</u>
Net margin (loss)	<u>33,017</u>	<u>26,121</u>	<u>79,129</u>	<u>70,216</u>

These interim financial statements are unaudited. In the opinion of management all adjustments, which are normal recurring accruals, necessary for the 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 2010 Annual Report.

Associated Electric Cooperative, Inc.
Balance Sheet
(in thousands)

	September 30, 2011	September 30, 2010
Assets		
Utility Plant:		
Electric plant in service	\$3,465,210	\$2,831,281
Construction work in progress	69,941	531,875
	3,535,151	3,363,157
Less accumulated depreciation	(1,384,714)	(1,295,793)
	2,150,437	2,067,364
Mining property and equipment		
Land	9,520	9,533
Equipment	6,328	6,323
	15,848	15,855
Less accumulated depreciation and depletion	(6,118)	(6,055)
	9,730	9,800
Other property and investments:		
Nonutility property	7,782	7,782
Net investment in direct financing leases	5,259	5,875
Advanced construction funds	14,243	15,709
Long-term investments	198	1,220
	27,481	30,586
Restricted assets:		
Investments in associated organizations	37,676	36,968
Other restricted assets and designated assets	161,398	59,614
	199,075	96,582
Current assets:		
Cash and cash equivalents	53,030	56,128
Restricted short-term investments	103,524	160,457
Accounts receivable, net	102,394	109,864
Fuel inventories	31,372	39,163
Materials and supplies inventories	61,269	56,520
Other current assets	9,969	9,493
	361,558	431,625
Deferred regulatory debits	62,759	66,557
Other deferred assets	16,486	16,153
	79,245	82,710
Total Assets	2,827,527	2,718,666

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Associated Electric Cooperative, Inc.

Balance Sheet

(in thousands)

	<u>September 30, 2011</u>	<u>September 30, 2010</u>
Capitalization and Liabilities		
Patronage capital and other equities:		
Memberships	12	12
Patronage capital	448,801	402,526
Other equities	55,540	55,540
Accumulated other comprehensive inc. (exp)	(11,163)	(9,828)
	<u>493,190</u>	<u>448,250</u>
Long-term debt, excluding current maturities:		
Federal Financing Bank	1,140,493	839,274
National Rural Utilities Cooperative Finance Corp.	60,092	154,752
State Environmental Improvement and Energy Resources Authority (Missouri)		71,550
CoBank	305,402	419,081
Other long-term debt	220,180	164,801
	<u>1,726,167</u>	<u>1,649,457</u>
Asset retirement obligation	23,303	18,918
Accumulated provision for postretirement benefits	37,236	34,190
Current Liabilities:		
Payable to member cooperatives	67,810	63,147
Accounts payable	71,605	92,878
Other current and accrued liabilities	31,057	39,106
Current maturities of long-term debt	60,099	67,596
Current portion of asset retirement obligation	144	744
	<u>230,713</u>	<u>263,471</u>
Deferred regulatory credits	270,165	259,545
Other deferred liabilities	46,752	44,835
	<u>316,917</u>	<u>304,381</u>
Total Capitalization and Liabilities	<u><u>2,827,527</u></u>	<u><u>2,718,666</u></u>

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Associated Electric Cooperative, Inc.
Statement of Cash Flows

(in thousands)

	Nine Months Ending September 30, 2011	Nine Months Ending September 30, 2010
Cash flows from operating activities:		
Net margin(loss)	\$79,129	\$70,216
Adjustments to reconcile net margin to net cash provided by operating activities:		
Provision for depreciation and amortization	67,725	64,098
Amortization of mine close costs		
Amortization of loan expenses and other costs	1,785	1,482
Decrease (increase) in deferred debits	(10,356)	(22,626)
Increase (decrease) in deferred credits	(12,727)	(6,647)
Increase (decrease) in asset retirement obligation	(537)	1,446
Change in assets and liabilities:		
Accounts receivable	24,931	11,069
Fuel inventories	20,047	12,386
Materials and supplies inventories	(2,501)	(3,575)
Accounts payable	(28,943)	21,330
Other current and accrued liabilities	(11,650)	17,789
Other operating activities, net	16,837	13,086
Net cash provided by operating activities	143,740	180,054
Cash flows from investing activities:		
Construction expenditures for utility plant	(115,610)	(267,631)
Sale (purchase) of Mine P&E	41	78
Sale (purchase) of investments	(26,052)	12,633
Investments in associated organizations	(1,683)	(10,744)
Direct financing lease proceeds	284	(399)
Other investments	470	1,070
Net cash (used) in investing activities	(142,550)	(264,993)
Cash flows from financing activities:		
Increase (decrease) in net borrowings from member cooperatives	6,011	28,424
Issuance (retirement) of long-term debt, including change in current maturity	(54,501)	39,784
Retirement of patronage capital	(8,441)	(7,691)
Net cash (used) in financing activities	(56,931)	60,518
Net increase (decrease) in cash and cash equivalents	(55,742)	(24,422)
Cash and cash equivalents, beginning of period	108,772	80,550
Cash and cash equivalents, end of period	53,030	56,128
Supplemental disclosure of noncash activities:		
Fixed asset expenditures included in accounts payable	\$ 908	\$ 7,663

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