Associated Electric Cooperative Inc.

A Touchstone Energy® Cooperative

Financial Statements

For the Quarterly Periods Ended

September 30, 2018 and 2017

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, 2018 and 2017. 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, 2018, was $34.9 and $106.9 million, respectively, compared to $25.1 and $52.1 million in the same periods of 2017. Total assets at September 30, 2018, were $3.1 billion, an increase of $47.9 million over the balance at September 30, 2017. 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, 2018, increased $8.0 million, or 3.3%, and increased $76.6 million, or 11.1%, for the first nine months of 2018 as compared to the same periods of 2017. The increase for the quarter was due to higher member energy sales volume and higher billing demand. The increase for the nine-month period was due to the combination of a rate increase that was effective April 1, 2017, higher member energy sales volume and higher billing demand. For the nine-month period, base billing demand determinants increased 4.3% and energy sales volume increased 14.1% primarily due to weather and the addition of the Northeast Oklahoma Electric Cooperative load in June of 2017.

Revenue from nonmembers increased $26.0 million, or 66.4%, for the quarter ended September 30, 2018, and increased $65.3 million, or 50.3%, for the nine-month period ended September 30, 2018, as compared to the same periods of 2017. The increase in sales revenue was primarily due to additional sales into MISO from the Dell generation unit, which was registered into the MISO energy market effective December 1, 2017, as well as additional regular interchange sales and a contract sale to Magnitude 7 Metals. Interchange sales revenue for the third quarter of 2018 increased $25.3 million, or 82.1%, due to an increase of 91.3% in sales volume that more than offset a 4.8% decrease in the weighted average sales price. Interchange sales revenue for the nine month period increased $64.8 million, or 61.5%, due to a 4.5% increase in the weighted average sales price and an increase of 54.6% in sales volume.

Generation Operation

Generation operations expense increased $45.6 million and $110.1 million, or 42.5% and 37.0%, respectively, for the three and nine-month periods ended September 30, 2018, as compared to the same periods of 2017. This was primarily due to a 51.6% and 46.9% increase in total generation for the three and nine-month periods, respectively. The increase in total generation was driven primarily by a 102.0% and 173.6% increase in gas generation to support higher member and interchange sales volumes for the three and nine-month periods, respectively. The increase in gas

generation was primarily due to increased generation at Chouteau power plant and Dell power plant. Partially offsetting the cost of increased gas generation was lower Panhandle natural gas prices in 2018, as compared to 2017. Also contributing to the increase for the three and nine-month periods was the purchase of New Madrid Unit 1 from the City of New Madrid on April 30, 2018. Prior to the purchase, expenses related to the generation from Unit 1 were included in contracted generation.

Contracted Generation

Contracted generation expense decreased $29.0 million and $48.2 million, or 74.7% and 42.6%, respectively for the three and nine-month periods ended September 30, 2018, as compared to the same periods of 2017. The decrease in the three and nine-month periods was primarily due to the purchase of New Madrid Unit 1 on April 30, 2018. After the purchase, expenses related to the generation from Unit 1 were included in generation operation.

Generation Maintenance

Generation maintenance expense increased $6.6 million and $14.2 million, or 36.4% and 28.9%, respectively for the three and nine-month periods ended September 30, 2018, as compared to the same periods of 2017. The increase for both periods was primarily due to an increase in variable fees that resulted from increased generation at the gas plants and additional operating projects at the gas plants as compared to 2017.

Financial Position:

Significant changes in the balance sheet at September 30, 2018, as compared to the prior year include the following:

- Utility plant, including construction work in progress and net of accumulated depreciation, increased $56.0 million, or 2.8%, primarily due to the purchase of New Madrid Unit 1 on April 30, 2018.

- Accounts receivable increased $74.5 million, or 70.0%, primarily because member power bills were not due until October 1st.

- Fuel inventories decreased $8.0 million, or 13.6%, primarily due to a 14.9% decrease in tons of coal on the ground as compared to September 30, 2017.

- Deferred regulatory debits, including the current portion, decreased by $10.2 million, or 11.6%, primarily due to an $8.1 million decrease in deferred maintenance expense resulting from amortization of prior year projects in excess of current year additions for the coal and gas fleet, a $4.8 million decrease in deferred mark-to-market losses on diesel and interest rate hedging activity, and a $1.1 million decrease in deferred energy efficiency program expenses. The decrease was partially offset by a $4.0 million increase in the asset retirement obligation deferral.

- Other deferred assets decreased by $47.1 million, or 53.8%, primarily due to moving the prepayment for New Madrid 1 to Utility Plant as of April 30, 2018.

- Patronage capital increased $75.9 million, or 12.4%, due to margins and the retirement of $23.0 million in patronage capital in May of 2018.

- Long-term debt, including current maturities, decreased $109.3 million or 5.7%. This decrease was due to scheduled principal payments of $83.3 million and a $26.0 million decrease in the CoBank line of credit.

- Payable to member cooperatives increased by $65.0 million, or 253.9%, primarily because member power bill payments were not due until October 1st. The funds used to pay the power bills were held in the G&T investment accounts as of September 30th.

- Deferred regulatory credits increased by $18.6 million, or 11.2%, primarily due to the deferral in December of 2017 of $10.0 million of member revenue subject to future refund in the form of lower rate requirements and an increase of $9.1 million in the long-term deferred gain on diesel swaps.

Associated Electric Cooperative, Inc.
Statement of Operations
For the Nine Months Ending 9/30/2018
(In thousands of dollars)

	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Operating revenues:				
Members	$255,802	$247,762	$765,599	$688,957
Nonmembers	65,108	39,122	195,232	129,940
	320,910	286,884	960,831	818,897
Operating expenses:				
Generation operation	152,923	107,296	407,691	297,581
Contracted generation	9,803	38,792	64,908	113,136
Power purchased	22,043	21,054	90,081	86,220
Depreciation and amortization	22,312	20,788	65,259	62,317
Transmission	21,709	23,384	67,562	66,873
Generation maintenance	24,703	18,114	63,396	49,172
Administrative and general	16,659	16,354	49,775	47,707
Taxes	1,516	1,251	4,645	3,142
Accretion of asset retirement obligations	403	223	1,063	674
	272,071	247,256	814,380	726,822
Operating margin before interest expense	48,839	39,628	146,451	92,075
Interest Expense:				
Interest on long-term debt	20,122	20,665	60,434	60,703
Less: interest capitalized	(83)	(48)	(198)	(207)
	20,039	20,617	60,236	60,496
Operating margin	28,800	19,011	86,215	31,579
Nonoperating:				
Interest and dividend income	6,050	5,920	20,562	19,362
Other nonoperating income	304	297	850	1,489
Interest expense	(282)	(123)	(682)	(315)
Total nonoperating	6,072	6,094	20,730	20,536
Net margin (loss)	34,872	25,105	106,945	52,115

These interim financial statements 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 2017 Annual Report.

Associated Electric Cooperative, Inc.
Balance Sheet
For the Nine Months Ending 9/30/2018
(In thousands of dollars)

Assets	Current Month	Prior Year
Utility Plant:		
Electric plant in service	$4,168,958	$3,915,629
Construction work in progress	59,890	50,215
	4,228,848	3,965,844
Less accumulated depreciation	(2,164,165)	(1,957,191)
	2,064,683	2,008,653
Other property and investments:		
Nonutility property	13,012	13,012
Net investment in direct financing leases	3,658	3,935
Advanced construction funds	20,767	21,950
	37,437	38,897
Restricted assets:		
Investments in associated organizations	27,315	26,456
Other restricted assets and designated assets	310,079	345,321
	337,394	371,777
Current assets:		
Cash and cash equivalents	56,940	71,532
Restricted short-term investments	120,900	98,270
Accounts receivable, net	180,860	106,404
Fuel inventories	50,698	58,691
Materials and supplies inventories	82,991	77,820
Other current assets	22,504	17,185
Current portion of deferred regulatory debits	1,943	2,490
	516,836	432,392
Deferred regulatory debits	76,305	85,971
Other deferred assets	40,438	87,504
	116,743	173,475
Total Assets	3,073,093	3,025,194

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Associated Electric Cooperative, Inc.
Balance Sheet
For the Nine Months Ending 9/30/2018
(In thousands of dollars)

Capitalization and Liabilities		
Patronage capital and other equities:		
Memberships	12	12
Patronage capital	688,633	612,745
Other equities	55,540	55,540
Accumulated other comprehensive inc. (exp)	(11,670)	(4,289)
	732,515	664,008
Long-term debt, excluding current maturities:		
Federal Financing Bank	1,138,277	1,205,439
CoBank	224,899	271,194
Other long-term debt	356,286	369,672
	1,719,462	1,846,305
Asset retirement obligation	52,892	47,681
Accumulated provision for postretirement benefits	33,967	27,206
Current Liabilities:		
Payable to member cooperatives	90,642	25,613
Accounts payable	75,001	78,222
Other current and accrued liabilities	48,119	49,882
Current maturities of long-term debt	100,844	83,333
Current portion of asset retirement obligation	2,883	1,739
Current portion of deferred regulatory credits	7,708	1,934
	325,197	240,723
Deferred regulatory credits	176,014	163,217
Other deferred liabilities	33,047	36,055
	209,061	199,272
Total Capitalization and Liabilities	3,073,093	3,025,194

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Associated Electric Cooperative, Inc.
Statement of Cash Flows
(In thousands)

	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Cash flows from operating activities:		
Net margin(loss)	$106,944	$52,116
Adjustments to reconcile net margin to net		
Cash provided by operating activities:		
Provision for depreciation and amortization	71,553	70,277
Amortization of loan expenses and other costs	305	63
Decrease (increase) in deferred debits	5,026	7,316
Increase (decrease) in deferred credits	3,593	(1,316)
Increase (decrease) in asset retirement obligation	1,666	(1,592)
Change in assets and liabilities:		
Accounts receivable	(41,730)	32,386
Fuel inventories	8,833	15,385
Materials and supplies inventories	(5,210)	(2,273)
Accounts payable	(44,345)	(47,482)
Other current and accrued liabilities	10,661	13,461
Other operating activities, net	(2,928)	(387)
Net cash provided by operating activities	114,368	137,954
Cash flows from investing activities:		
Construction expenditures for utility plant	(80,957)	(50,413)
Sale (purchase) of investments	9,756	(84,986)
Investments in associated organizations	80	(65)
Direct financing lease proceeds	209	193
Other investments	351	57
Reimbursement of capital expenditures	(17)	(15)
Net cash (used) in investing activities	(70,578)	(135,229)
Cash flows from financing activities:		
Increase (decrease) in net borrowings from member cooperatives	61,877	(6,159)
Issuance (retirement) of long-term debt, including change in current maturity	(124,703)	(10,727)
Retirement of patronage capital	(22,961)	(12,486)
Net cash (used) in financing activities	(85,787)	(29,372)
Net increase (decrease) in cash and cash equivalents	(41,997)	(26,647)
Cash and cash equivalents, beginning of period	98,937	98,179
Cash and cash equivalents, end of period	56,940	71,532
Supplemental disclosure of noncash activities:		
Change in plant expenditures included in accounts payable	(478)	(8,664)
Supplemental disclosure of cash flow information:		
Cash paid for interest (net of amount capitalized)	61,574	60,082

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