

Associated Electric Cooperative Inc.

A Touchstone Energy[®] Cooperative 

Financial Statements

For the Quarterly Periods Ended

March 31, 2019 and 2018

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, 2019 and 2018. 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-month period ended March 31, 2019, was \$39.1 million as compared to \$38.7 million in the same period of 2018. Total assets were \$3.1 billion at March 31, 2019 as compared to \$3.0 billion at March 31, 2018. 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 March 31, 2019, decreased \$1.7 million, or 0.7%, as compared to the same period of 2018. Member revenue consists of an energy and a demand component. Energy revenue increased \$3.0 million due to a 1.9% increase in energy sales volume, as compared to the same period of 2018. Demand revenue decreased by \$4.8 million. Base billing demand determinants increased 8.8% but were more than offset by a demand rate discount of \$1.12/kW that was approved by Associated's board for 2019.

Revenue from nonmembers increased \$19.3 million, or 35.3%, for the first quarter of 2019 as compared to the same period of 2018. The increase was primarily due to a \$17.0 million increase in nonmember energy sales. Sales volumes increased 54.1%, offset in part by an 11.9% decrease in the weighted average sales price. The majority of the increase in nonmember energy sales was related to supplying energy to an aluminum smelter that began in May of 2018, which also resulted in an increase in capacity sales revenue, as compared to the same period of 2018.

Generation Operation

Generation operations expense increased \$41.9 million, or 35.2%, for the first quarter of 2019 as compared to the same period of 2018. This increase was primarily related to 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. After the purchase, expenses related to the generation of Unit 1 were included in generation operation. Also contributing to the increase in generation operations was higher gas generation, which increased by 42.0%, or 819,349 MWh, for the first three months of 2019 as compared to the same period of 2018. The gas units, some of which were the lowest cost generation assets, were dispatched to support higher member and nonmember sales volumes. The increase in gas generation was primarily at the Chouteau power plant

due to low natural gas prices in the Oklahoma market and the Dell power plant due to operating in the MISO market.

Contracted Generation

Contracted generation expense decreased \$26.7 million, or 70.4% for the three months ended March 31, 2019, as compared to the same period of 2018. Contracted generation consists of firm capacity received from Associated's hydropower contract and generating units that Associated has contracted to dispatch up to a given quantity of power for at least one year, and for which Associated has operating expense responsibility. The decrease was mainly 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.

Purchased Power

Purchased power expense decreased \$5.8 million, or 15.7% for the three months ended March 31, 2019, as compared to the same period of 2018. Purchased power includes expenses related to purchases from interchange partners on the wholesale market, supplemental hydropower, and energy purchased from wind farms. The decrease for the three-month period ended March 31, 2019, was primarily due to a \$6.2 million decrease in wind purchases as compared to the same period of 2018. Interchange purchases also decreased by \$2.7 million as a result of a 32.7% decrease in purchase volume and a 25.4% decrease in interchange purchase price, as compared to the same period of 2018. Partially offsetting these decreases was an increase of \$2.6 million in supplemental hydro purchases.

Generation Maintenance

Generation maintenance expense increased \$5.9 million, or 37.0% for the three months ended March 31, 2019, as compared to the same period of 2018. The increase 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 2018.

Financial Position:

Significant changes in the balance sheet at March 31, 2019, as compared to the prior year include the following:

- Utility plant, including construction work in progress and net of accumulated depreciation, increased \$76.9 million, or 3.9%, primarily due to the purchase of New Madrid Unit 1 on April 30, 2018 and projects at the coal plants.
- Nonutility property increased \$18.7 million, or 143.3%, due to AECI Land, LLC's purchase of additional nonutility property in the St. Jude Industrial Park on November 1, 2018.

- Other restricted and designated assets and restricted short-term investments increased \$39.8 million, or 8.9%, primarily due to an increase of \$41.8 million in the cushion of credit and a decrease of \$2.0 million in other investments and pledged securities.
- Fuel inventories decreased \$13.4 million, or 23.7%, primarily due to a 41.6% decrease in tons of coal on the ground as compared to March 31, 2018.
- Other deferred assets decreased by \$46.5 million, or 55.5%, primarily due to reclassification of the prepayment for New Madrid 1 to Utility Plant upon purchase of the unit on April 30, 2018.
- Patronage capital increased \$30.1 million, or 4.7%, due to margins and the retirement of \$23.0 million in patronage capital in May of 2018.
- Long-term debt, including current maturities, decreased \$24.6 million or 1.3%. This decrease was due to a \$60.0 million increase in line of credit borrowing offset by \$84.6 million in scheduled principal payments.
- Deferred regulatory credits, including the current portion, increased by \$71.8 million, or 40.2%, primarily due to the deferral in December of 2018 of \$72.0 million of member revenue subject to future refund in the form of lower rate requirements.

Associated Electric Cooperative, Inc.
Statement of Operations
For the Three Months Ending 3/31/2019
(In thousands of dollars)

	Three Months Ended March 31		Three Months Ended March 31	
	2019	2018	2019	2018
Operating revenues:				
Members	265,151	266,882	265,151	266,882
Nonmembers	74,174	54,837	74,174	54,837
	<u>339,325</u>	<u>321,719</u>	<u>339,325</u>	<u>321,719</u>
Operating expenses:				
Generation operation	160,909	119,056	160,909	119,056
Power purchased	30,891	36,655	30,891	36,655
Depreciation and amortization	22,304	21,031	22,304	21,031
Transmission Expense	22,997	23,132	22,997	23,132
Generation maintenance	21,856	15,958	21,856	15,958
Contracted generation	11,204	37,890	11,204	37,890
Administrative and general	16,851	16,398	16,851	16,398
Taxes	1,698	1,690	1,698	1,690
Accretion of asset retirement obligations	412	297	412	297
	<u>289,122</u>	<u>272,106</u>	<u>289,122</u>	<u>272,106</u>
Operating margin before interest expense	<u>50,203</u>	<u>49,613</u>	<u>50,203</u>	<u>49,613</u>
Interest Expense:				
Interest on long-term debt	20,093	20,007	20,093	20,007
Less: interest capitalized	(492)	(51)	(492)	(51)
	<u>19,601</u>	<u>19,956</u>	<u>19,601</u>	<u>19,956</u>
Operating margin	<u>30,602</u>	<u>29,657</u>	<u>30,602</u>	<u>29,657</u>
Nonoperating:				
Interest and dividend income	8,397	8,918	8,397	8,918
Other nonoperating income	365	299	365	299
Interest expense	(309)	(151)	(309)	(151)
Total nonoperating	<u>8,453</u>	<u>9,066</u>	<u>8,453</u>	<u>9,066</u>
Net margin (loss)	<u><u>39,055</u></u>	<u><u>38,723</u></u>	<u><u>39,055</u></u>	<u><u>38,723</u></u>

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 2018 Annual Report.

Associated Electric Cooperative, Inc.
Balance Sheet
For the Three Months Ending 3/31/2019
(In thousands of dollars)

Assets	<u>Current Month</u>	<u>Prior Year</u>
Utility Plant:		
Electric plant in service	\$4,193,202	\$3,946,083
Construction work in progress	89,504	45,937
	<u>4,282,706</u>	<u>3,992,020</u>
Less accumulated depreciation	(2,212,012)	(1,998,196)
	<u>2,070,694</u>	<u>1,993,824</u>
Other property and investments:		
Nonutility property	31,663	13,012
Net investment in direct financing leases	3,512	3,799
Advanced construction funds	20,175	21,359
	<u>55,350</u>	<u>38,170</u>
Restricted assets:		
Investments in associated organizations	28,108	27,269
Other restricted assets and designated assets	370,418	352,758
	<u>398,525</u>	<u>380,027</u>
Current assets:		
Cash and cash equivalents	83,969	72,799
Restricted short-term investments	119,488	97,336
Accounts receivable, net	118,061	125,614
Fuel inventories	43,319	56,742
Materials and supplies inventories	84,610	79,855
Other current assets	17,306	21,070
Current portion of deferred regulatory debits	1,787	2,093
	<u>468,540</u>	<u>455,509</u>
Deferred regulatory debits	84,914	80,882
Other deferred assets	37,328	83,861
	<u>122,242</u>	<u>164,743</u>
 Total Assets	 <u>3,115,351</u>	 <u>3,032,273</u>

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Associated Electric Cooperative, Inc.
Balance Sheet
For the Three Months Ending 3/31/2019
(In thousands of dollars)

	Current Month	Prior Year
Capitalization and Liabilities		
Patronage capital and other equities:		
Memberships	12	12
Patronage capital	673,485	643,373
Other equities	55,561	55,540
Accumulated other comprehensive inc. (exp)	(14,551)	(11,983)
	714,507	686,943
Long-term debt, excluding current maturities:		
Federal Financing Bank	1,111,656	1,178,681
CoBank	291,118	251,944
Other long-term debt	352,640	364,688
	1,755,415	1,795,313
Asset retirement obligation	39,182	51,492
Accumulated provision for postretirement benefits	35,066	33,376
Current Liabilities:		
Payable to member cooperatives	36,751	34,686
Accounts payable	89,646	87,959
Other current and accrued liabilities	44,441	40,289
Current maturities of long-term debt	99,898	84,605
Current portion of asset retirement obligation	14,926	3,262
Current portion of deferred regulatory credits	2,870	4,442
	288,533	255,243
Deferred regulatory credits	247,393	174,010
Other deferred liabilities	35,255	35,896
	282,648	209,906
Total Capitalization and Liabilities	3,115,351	3,032,273

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

	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Cash flows from operating activities:		
Net margin(loss)	\$39,097	\$38,723
Adjustments to reconcile net margin to net		
Cash provided by operating activities:		
Provision for depreciation and amortization	23,522	23,414
Amortization of loan expenses and other costs	144	112
Decrease (increase) in deferred debits	3,360	4,406
Increase (decrease) in deferred credits	4,852	(950)
Increase (decrease) in asset retirement obligation	560	645
Change in assets and liabilities:		
Accounts receivable	12,418	13,504
Fuel inventories	4,303	2,788
Materials and supplies inventories	(443)	(2,074)
Accounts payable	(36,429)	(31,865)
Other current and accrued liabilities	14,439	1,694
Other operating activities, net	(1,209)	(1,476)
Net cash provided by operating activities	64,614	48,921
Cash flows from investing activities:		
Construction expenditures for utility plant	(19,229)	(6,482)
Sale (purchase) of investments	(5,465)	(9,440)
Investments in associated organizations	(560)	(466)
Direct financing lease proceeds	74	68
Other investments	450	432
Reimbursement of capital expenditures	(3)	(5)
Net cash (used) in investing activities	(24,733)	(15,893)
Cash flows from financing activities:		
Increase (decrease) in net borrowings from member cooperatives	1,639	5,921
Issuance (retirement) of long-term debt, including change in current maturity	(59,667)	(65,090)
Net cash (used) in financing activities	(58,028)	(59,169)
Net increase (decrease) in cash and cash equivalents	(18,147)	(26,141)
Cash and cash equivalents, beginning of period	102,115	98,937
Cash and cash equivalents, end of period	83,968	72,799
Supplemental disclosure of noncash activities:		
Change in plant expenditures included in accounts payable	(6,297)	(1,517)
Supplemental disclosure of cash flow information:		
Cash paid for interest (net of amount capitalized)	7,342	20,465

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