

Associated Electric Cooperative Inc.

A Touchstone Energy[®] Cooperative 

Financial Statements

For the Quarterly Periods Ended

June 30, 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 June 30, 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 and six-month period ended June 30, 2019, was \$30.3 and \$69.3 million, respectively, compared to \$33.4 and \$72.1 million in the same periods of 2018. Total assets were \$3.1 billion at both June 30, 2019 and June 30, 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 decreased \$25.0 million and \$26.8 million, or 10.3% and 5.3%, respectively, for the second quarter and the six-month period ended June 30, 2019, as compared to the same periods of 2018. Member revenue consists of an energy and a demand component. Energy revenue decreased \$20.0 and \$16.9 million, due to a 14.4% and 5.6% decrease in energy sales volume, as compared to the same periods of 2018. Demand revenue decreased by \$5.1 and \$9.8 million, as compared to the same periods of 2018. Base billing demand determinants increased 8.7% and 8.8%, respectively, 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 \$19.0 million and \$38.3 million, or 25.2% and 29.5%, respectively, for the second quarter and the six-month period ended June 30, 2019, as compared to the same periods of 2018. The increase for both periods was primarily due to a \$16.9 and \$33.9 million increase in nonmember energy sales. Sales volumes increased 37.1% and 43.8%, respectively, offset in part by an 8.6% and 9.8% decrease in the weighted average sales price as compared to the same periods of 2018. The majority of the increase in nonmember energy sales for both periods 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 periods of 2018.

Generation Operation

Generation operations expense increased \$2.3 million and \$44.2 million, or 1.7% and 17.3%, respectively, for the three and six-month periods ended June 30, 2019, as compared to the same periods 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. Also contributing to the increase in generation operations was higher gas generation, which increased 23.9% and 32.5%, respectively, for the three and six-month periods ended June

30, 2019, as compared to the same periods of 2018. The increase in gas generation was primarily due to the Dell power plant operating in the MISO market and increased generation at Chouteau power plant due to lower natural gas prices in the Oklahoma market.

Contracted Generation

Contracted generation expense decreased \$7.0 million and \$33.6 million, or 40.4% and 61.1%, respectively, for the three and six-month periods ended June 30, 2019 as compared to the same periods 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 in the three and six-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.

Purchased Power

Purchased power expenses decreased \$1.5 million and \$7.3 million, or 4.9% and 10.8%, respectively, for the three and six-month periods ended June 30, 2019 as compared to the same periods 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 and six-month periods was primarily due to a decrease in wind purchases of \$4.5 and \$10.3 million, respectively. The decrease in wind purchases was due to a 14.1% and 16.7% decrease in purchase volumes from the windfarms, respectively, for the three and six-month periods. Partially offsetting the decrease in wind purchases was a \$0.5 and \$3.2 million increase in supplemental hydro purchases, respectively, for the three and six-month periods ended June 30, 2019 as compared to the same periods of 2018. Interchange purchases increased \$2.5 million for the second quarter but decreased \$0.2 million year-to-date.

Generation Maintenance

Generation maintenance expense increased \$2.0 million and \$7.9 million, or 8.7% and 20.4%, respectively, for the three and six-month periods ended June 30, 2019, as compared to the same periods of 2018. 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 2018.

Financial Position:

Significant changes in the balance sheet at June 30, 2019, as compared to the prior year include the following:

- Utility plant, including construction work in progress, increased \$86.4 million, or 2.1%, primarily due to cyclone and generator projects at the New Madrid power plant and various ongoing projects at the Thomas Hill and Dell power 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 assets and designated assets and restricted short-term investments increased \$45.3 million, or 10.1%, primarily due to an increase in funds invested in the RUS cushion of credit.
- Accounts receivable increased \$39.5 million, or 30.3%, primarily because May member power bills were not due until July 1.
- Fuel inventories decreased \$17.3 million, or 30.3%, primarily due to a 40.6% decrease in tons of coal on the ground as compared to June 30, 2018.
- Deferred regulatory debits, including the current portion, increased by \$8.3 million, or 10.3%, primarily due to an \$8.4 million increase in deferred losses on diesel and interest rate hedging activity and a \$2.1 million increase in the deferral of asset retirement obligation costs. The increase was partially offset by a \$1.2 million decrease in deferred maintenance expense, related to projects at the New Madrid power plant, and an \$0.8 million decrease in deferred energy efficiency program expenses.
- Patronage capital increased \$26.5 million, or 4.1%, due to margins and the retirement of \$23.5 million in patronage capital in May of 2019.
- Payable to member cooperatives increased by \$41.2 million, or 112.8%, primarily because member power bill payments were not due until July 1. The funds used to pay the power bills were held in the G&T investment accounts as of June 30th.
- Other current and accrued liabilities increased by \$6.7 million, or 15.6%. This was primarily due to a \$2.5 million increase in customer security deposits, a \$2.9 million increase in hedging payable, and an \$0.8 million increase in transmission study deposits.
- Long-term debt, including current maturities, decreased \$63.3 million or 3.4%. This decrease was due to \$85.1 million in scheduled principal payments and a \$44.0 million decrease in outstanding lines of credit that was partially offset by two RUS advances of \$17.0 million for the transmission construction work plan and \$48.8 million for the New Madrid Unit 1 purchase.
- Deferred regulatory credits, including the current portion, increased by \$66.4 million, or 36.6%, primarily due to a \$72.0 million deferral in December 2018 of member revenue subject to future refund in the form of lower rate requirements and a \$3.5 million increase in deferred gains on natural gas swaps. Partially offsetting the increases was a \$7.7

million decrease in deferred gains on diesel swaps and a \$1.4 million recognition of previously deferred revenue related to the New Madrid Unit 1 purchase.

Associated Electric Cooperative, Inc.
Statement of Operations
For the Six Months Ending 6/30/2019
(In thousands of dollars)

	Three Months Ended June 30		Six Months Ended June 30	
	2019	2018	2019	2018
Operating revenues:				
Members	\$217,878	\$242,916	\$483,029	\$509,798
Nonmembers	94,295	75,287	168,469	130,124
	<u>312,173</u>	<u>318,203</u>	<u>651,498</u>	<u>639,922</u>
Operating expenses:				
Generation operation	138,610	136,280	299,519	255,336
Contracted generation	10,257	17,214	21,461	55,104
Power purchased	29,301	30,815	60,193	67,470
Depreciation and amortization	22,334	21,916	44,638	42,947
Transmission Expense	23,233	22,720	46,230	45,852
Generation maintenance	24,710	22,735	46,566	38,693
Administrative and general	18,753	16,718	35,604	33,116
Taxes	1,340	1,439	3,038	3,129
Accretion of asset retirement obligations	421	364	833	661
	<u>268,959</u>	<u>270,201</u>	<u>558,082</u>	<u>542,308</u>
Operating margin before interest expense	<u>43,214</u>	<u>48,002</u>	<u>93,417</u>	<u>97,614</u>
Interest Expense:				
Interest on long-term debt	19,825	20,306	39,918	40,312
Less: interest capitalized	(503)	(63)	(995)	(114)
	<u>19,322</u>	<u>20,243</u>	<u>38,923</u>	<u>40,198</u>
Operating margin	<u>23,892</u>	<u>27,759</u>	<u>54,494</u>	<u>57,416</u>
Nonoperating:				
Interest and dividend income	6,424	5,594	14,822	14,511
Other nonoperating income	362	247	727	546
Interest expense	(413)	(249)	(722)	(400)
Total nonoperating	<u>6,373</u>	<u>5,592</u>	<u>14,827</u>	<u>14,657</u>
Net margin (loss)	<u><u>30,265</u></u>	<u><u>33,351</u></u>	<u><u>69,321</u></u>	<u><u>72,073</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 Six Months Ending 6/30/2019
(In thousands of dollars)

Assets	<u>Current Month</u>	<u>Prior Year</u>
Utility Plant:		
Electric plant in service	\$4,198,795	\$4,159,288
Construction work in progress	100,790	53,885
	<u>4,299,585</u>	<u>4,213,173</u>
Less accumulated depreciation	<u>(2,235,459)</u>	<u>(2,140,082)</u>
	<u>2,064,126</u>	<u>2,073,091</u>
Other property and investments:		
Nonutility property	31,663	13,012
Net investment in direct financing leases	3,436	3,729
Advanced construction funds	19,879	21,063
	<u>54,978</u>	<u>37,804</u>
Restricted assets:		
Investments in associated organizations	27,980	27,172
Other restricted assets and designated assets	374,994	353,477
	<u>402,974</u>	<u>380,649</u>
Current assets:		
Cash and cash equivalents	61,331	61,174
Restricted short-term investments	120,844	97,080
Accounts receivable, net	169,814	130,311
Fuel inventories	39,716	57,015
Materials and supplies inventories	86,755	82,330
Other current assets	14,018	18,926
Current portion of deferred regulatory debits	4,518	2,353
	<u>496,996</u>	<u>449,189</u>
Deferred regulatory debits	84,891	78,722
Other deferred assets	39,003	41,648
	<u>123,894</u>	<u>120,370</u>
 Total Assets	 <u><u>3,142,968</u></u>	 <u><u>3,061,103</u></u>

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Associated Electric Cooperative, Inc.
Balance Sheet
For the Six Months Ending 6/30/2019
(In thousands of dollars)

	Current Month	Prior Year
Capitalization and Liabilities		
Patronage capital and other equities:		
Memberships	12	12
Patronage capital	680,247	653,762
Other equities	55,561	55,540
Accumulated other comprehensive inc. (exp)	(14,322)	(11,826)
	721,498	697,488
Long-term debt, excluding current maturities:		
Federal Financing Bank	1,164,274	1,165,344
CoBank	216,132	281,230
Other long-term debt	345,185	358,831
	1,725,591	1,805,405
Asset retirement obligation	39,777	52,187
Accumulated provision for postretirement benefits	35,438	33,672
Current Liabilities:		
Payable to member cooperatives	77,792	36,559
Accounts payable	90,004	88,374
Other current and accrued liabilities	49,271	42,621
Current maturities of long-term debt	101,559	85,082
Current portion of asset retirement obligation	14,619	3,473
Current portion of deferred regulatory credits	1,706	5,906
	334,951	262,015
Deferred regulatory credits	246,052	175,413
Other deferred liabilities	39,661	34,923
	285,713	210,336
Total Capitalization and Liabilities	3,142,968	3,061,103

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

	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
Cash flows from operating activities:		
Net margin(loss)	\$69,321	\$72,073
Adjustments to reconcile net margin to net		
Cash provided by operating activities:		
Provision for depreciation and amortization	47,158	47,392
Amortization of loan expenses and other costs	283	204
Decrease (increase) in deferred debits	2,566	2,207
Increase (decrease) in deferred credits	2,702	1,993
Increase (decrease) in asset retirement obligation	851	1,552
Change in assets and liabilities:		
Accounts receivable	(39,328)	8,814
Fuel inventories	7,905	2,516
Materials and supplies inventories	(2,589)	(4,549)
Accounts payable	(36,071)	(31,450)
Other current and accrued liabilities	19,838	4,596
Other operating activities, net	2,434	722
Net cash provided by operating activities	75,071	106,070
Cash flows from investing activities:		
Construction expenditures for utility plant	(36,258)	(64,726)
Sale (purchase) of investments	(11,331)	(9,859)
Investments in associated organizations	(136)	(74)
Direct financing lease proceeds	149	138
Other investments	384	389
Reimbursement of capital expenditures	(10)	(11)
Net cash (used) in investing activities	(47,201)	(74,143)
Cash flows from financing activities:		
Increase (decrease) in net borrowings from member cooperatives	42,681	7,794
Issuance (retirement) of long-term debt, including change in current maturity	(87,831)	(54,521)
Retirement of patronage capital	(23,504)	(22,961)
Net cash (used) in financing activities	(68,654)	(69,688)
Net increase (decrease) in cash and cash equivalents	(40,784)	(37,761)
Cash and cash equivalents, beginning of period	102,115	98,937
Cash and cash equivalents, end of period	61,331	61,174
Supplemental disclosure of noncash activities:		
Change in plant expenditures included in accounts payable	(4,658)	(3,202)
Supplemental disclosure of cash flow information:	27,260	41,194
Cash paid for interest (net of amount capitalized)		

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