

May 15, 2002

Enclosed is the TVA Power Program 2002 Second Quarter Report. As the report explains, the past six months have been challenging for TVA, as well as most of the utility industry, as the nation experienced one of the mildest winters in over a century. TVA also recently decided not to complete a gas-fired, combined-cycle plant due to changing market conditions. The cancellation and write-down of this project investment resulted in a net loss for the quarter.

Fortunately, as the competitive landscape shifts and future market assumptions change, our long-term financial strategies and the financial disciplines we follow give us the flexibility needed to mitigate the short-term adverse business conditions we've just experienced.

- *Improving Cash Flow*

Cash flow from operations improved by 135 percent between 1995 and 2001, giving TVA a sufficient cushion to service our capital structure and meet the growing needs of the Tennessee Valley.

- *Reducing Debt Burden*

The improvement in cash flow over the last few years has enabled us to reduce our overall level of debt by \$2.35 billion while at the same time increasing our net winter dependable capacity by over 1,900 megawatts since 1997.

Also, the average interest rate on TVA's outstanding debt has been reduced to 5.8 percent in 2002, compared to 7.3 percent in 1997.

- *Lowering Interest Expense*

The combination of lower debt and lower interest rates means TVA's annual interest expense has been reduced by \$370 million from its high in 1997. Moreover, TVA's net interest expense compared to total revenue is the lowest it's been in 15 years.

TVA is financially sound and is well positioned for the restructured and competitive environment of the future. We will continue to run TVA like a competitive business with the ultimate goal of providing the best service for the people of the Tennessee Valley.



David N. Smith

Enclosure

T E N N E S S E E V A L L E Y A U T H O R I T Y



P O W E R P R O G R A M

Second Quarter Report

2002



Letter From the Chairman

TVA is in good shape and we're determined to be even better. TVA had a number of accomplishments in the second quarter that demonstrate the innovative, business-like and competitive spirit of our employees.

The demand for power from TVA and other electric utilities is largely driven by the weather. This past winter was one of the warmest in 107 years, according to the National Climatic Data Center. This mild weather was the primary reason that TVA's revenues were down by 8.6 percent through the second quarter compared to the same period last year.

The weather in January 2002 also presented a challenge in balancing the integrated management of the Tennessee River system. An average of 3.9 inches of rain fell Valleywide in a 72-hour period and flood control quickly became a top priority. TVA helped prevent over \$90 million in potential property damage along the Tennessee River system during the second quarter.

New innovations by TVA employees during the second quarter are helping TVA to achieve another strategic objective—meeting our customers' needs by providing affordable, reliable electric power. TVA employees designed and installed a new dynamic transmission map board to help control 17,000 miles of transmission line and 973 interchange and delivery points. Knowing the real-time status of 33,000 transmission points helps to improve reliability by reducing our customers' outage time.

TVA also partnered with the Electric Power Research Institute (EPRI) to test the "DayCor" camera that allows early detection of deteriorating transmission lines and substation electrical equipment to help lower maintenance costs. And we are partnering with Iowa's Waverly Light and Power to test BioTrans, a soybean-based electric-transformer oil which

replaces petroleum-based mineral oils. BioTrans is biodegradable, nontoxic and contains no hazardous materials, which helps reduce environmental risks and costs.

The 13,488 men and women of TVA are working diligently to cut costs and improve our performance. All of us are committed to achieving excellence in business performance and public service for the benefit of the people of the Tennessee Valley.



Glenn L. McCullough, Jr.

Chairman

Financial Highlights (millions)

Six Months Ended March 31	2002	2001
Operating revenues	\$ 3,174	\$ 3,473
Operating expenses	(2,401)	(2,701)
Operating income	773	772
Other income, net	8	239
Interest expense	(717)	(842)
Income before loss on project cancellation	64	169
Loss on project cancellation	(150)	—
Net (loss) income	\$ (86)	\$ 169

Sales of Electricity (millions - kWh)

Six Months Ended March 31	2002	2001
Municipalities and cooperatives	59,633	64,121
Industries directly served	13,548	12,234
Federal agencies and other utilities	2,648	4,728
Total sales of electricity	75,829	81,083

Management Discussion and Analysis

TVA realized net income before loss on project cancellation of \$61 million and \$64 million for the three months and six months ended March 31, 2002, as compared with \$122 million and \$169 million for the same periods last year. TVA also recognized a loss on project cancellation of \$150 million in March 2002 which resulted in net losses for the second quarter and the year-to-date of \$89 million and \$86 million, respectively.

Operating Revenues

Operating revenues for the second quarter were \$1,653 million, compared with \$1,758 million for the same period last year. Fiscal year-to-date operating revenues were \$3,174 million, compared with \$3,473 million for the same period last year. The \$299 million decrease for the six-month period was primarily due to lower energy sales of 5.3 billion kWh (or 6.5 percent), of which 4.5 billion kWh was attributable to lower demand from the municipalities and cooperatives segment. The significant decline in sales is the result of unseasonably warm weather experienced during the winter of fiscal year 2002.

Operating Expenses

Operating expenses through the second quarter of 2002 were \$2,401 million, compared with \$2,701 million for the same period last year. Fuel and purchased power expense decreased \$99 million as a result of lower generation. Additionally, depreciation and amortization expenses decreased \$346 million, primarily due to a charge in excess of \$200 million last year for the acceleration of the amortization of regulatory assets. Operating and maintenance expense increased \$138 million, reflecting an increase in workers' compensation expense and lower earnings on pension assets.

Other Income

Other income in the prior year included the receipt of an amount in excess of \$200 million under settlement of litigation involving a power purchase contract in 2001.

Interest Expense

Net interest expense declined \$57 million and \$125 million for the three months and six months ended March 31, 2002, respectively, compared with the same periods of 2001. These declines reflect lower average interest rates and a lower level of total outstanding debt during fiscal year 2002.

Loss on Project Cancellation

Due to changes in the three to five year forecast of energy supply and market opportunities, TVA elected not to complete a gas-fired combined-cycle plant that would have provided 510 MW of power in 2004. Accumulated costs, net of estimated salvage, associated with the project total approximately \$150 million, which TVA recognized in the second quarter as a loss on project cancellation. If continued, an additional investment of approximately \$224 million would have been required to complete the project.

Financial Position

Cash used in financing activities reflects a reduction in net borrowings from 2001 to 2002 of \$267 million for the quarter. For the six months, net borrowings were \$380 million less than the previous period in part reflecting the utilization of \$320 million in proceeds from a lease/lease-back financing transaction.

Balance Sheets (unaudited)

	March 31 2002	September 30 2001
	(MILLIONS)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 11	\$ 339
Accounts receivable	503	720
Inventories (at average cost) and other		
Fuel	190	170
Other	<u>292</u>	<u>272</u>
Total current assets	996	1,501
Property, plant, and equipment		
Completed plant	30,630	30,467
Less accumulated depreciation	<u>(10,794)</u>	<u>(10,344)</u>
Net completed plant	19,836	20,123
Construction in progress	1,187	923
Deferred nuclear generating units	4,079	4,110
Nuclear fuel and capital lease assets	<u>537</u>	<u>487</u>
Total property, plant, and equipment	25,639	25,643
Investment funds		
	698	725
Deferred charges and other assets		
Loans and other long-term receivables	133	124
Debt issue and reacquisition costs	180	140
Other deferred charges	<u>1,309</u>	<u>1,566</u>
Total deferred charges and other assets	1,622	1,830
Total assets	<u>\$ 28,955</u>	<u>\$ 29,699</u>
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable	\$ 590	\$ 710
Accrued liabilities	187	235
Accrued interest	403	389
Short-term debt	2,021	3,016
Current maturities of long-term debt	<u>1,984</u>	<u>1,984</u>
Total current liabilities	5,185	6,334
Other liabilities		
	2,827	2,806
Long-term debt		
Public bonds	20,811	20,375
Unamortized discount and other	<u>(558)</u>	<u>(524)</u>
Total long-term debt	20,253	19,851
Proprietary capital		
Appropriation investment	498	508
Retained earnings	205	306
Accumulated other comprehensive loss	<u>(13)</u>	<u>(106)</u>
Total proprietary capital	690	708
Total liabilities and proprietary capital	<u>\$ 28,955</u>	<u>\$ 29,699</u>

Statements of Income (unaudited)

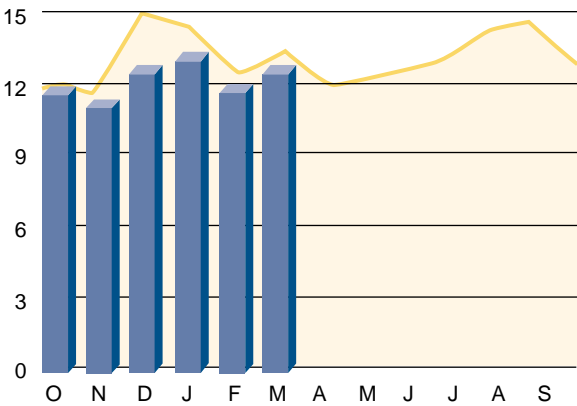
	Three Months Ended March 31		Six Months Ended March 31	
	2002	2001	2002	2001
	(MILLIONS)		(MILLIONS)	
Operating revenues				
Sales of electricity				
Municipalities and cooperatives	\$ 1,403	\$ 1,472	\$ 2,704	\$ 2,928
Industries directly served	190	163	352	327
Federal agencies and other utilities	38	104	80	178
Other revenue	<u>22</u>	<u>19</u>	<u>38</u>	<u>40</u>
Total operating revenues	1,653	1,758	3,174	3,473
Operating expenses				
Fuel and purchased power	449	453	834	933
Operating and maintenance	439	365	864	726
Depreciation and amortization	271	559	540	886
Tax-equivalents	<u>81</u>	<u>78</u>	<u>163</u>	<u>156</u>
Total operating expenses	1,240	1,455	2,401	2,701
Operating income	413	303	773	772
Other income, net	<u>5</u>	<u>233</u>	<u>8</u>	<u>239</u>
Income before interest expense	418	536	781	1,011
Interest expense				
Interest on debt	368	406	736	826
Amortization of debt discount, issue, and reacquisition costs, net	5	22	11	43
Allowance for funds used during construction	<u>(16)</u>	<u>(14)</u>	<u>(30)</u>	<u>(27)</u>
Net interest expense	357	414	717	842
Income before loss on project cancellation	61	122	64	169
Loss on project cancellation	<u>(150)</u>	<u>—</u>	<u>(150)</u>	<u>—</u>
Net (loss) income	\$ (89)	\$ 122	\$ (86)	\$ 169

Statements of Cash Flows (unaudited)

	Three Months Ended March 31		Six Months Ended March 31	
	2002	2001	2002	2001
	(MILLIONS)		(MILLIONS)	
Cash flows from operating activities				
Net (loss) income	\$ (89)	\$ 122	\$ (86)	\$ 169
Net items not requiring cash	451	595	748	950
Other changes, net	<u>162</u>	<u>152</u>	<u>(81)</u>	<u>(7)</u>
Net cash provided by operations	524	869	581	1,112
Cash flows from investing activities				
Construction expenditures	(283)	(239)	(632)	(448)
Allowance for funds used during construction	16	14	30	27
Other, net	<u>93</u>	<u>(22)</u>	<u>(11)</u>	<u>(51)</u>
Net cash used in investing activities	(174)	(247)	(613)	(472)
Cash flows from financing activities				
Borrowings, net	(334)	(601)	(558)	(938)
Proceeds from combustion turbine lease/leaseback	—	—	320	—
Other	<u>(15)</u>	<u>(24)</u>	<u>(58)</u>	<u>(38)</u>
Net cash used in financing activities	(349)	(625)	(296)	(976)
Net change in cash and cash equivalents	\$ 1	\$ (3)	\$ (328)	\$ (336)

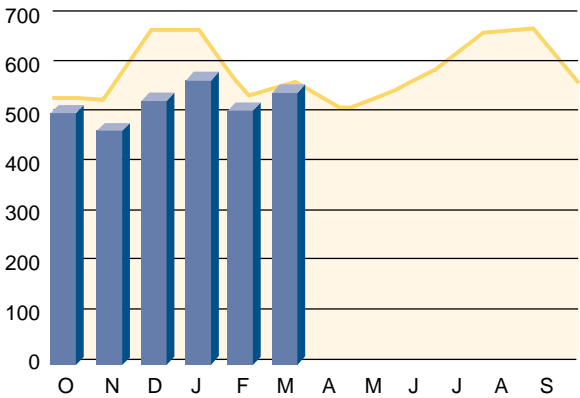
Total TVA Generation

billions of kwh



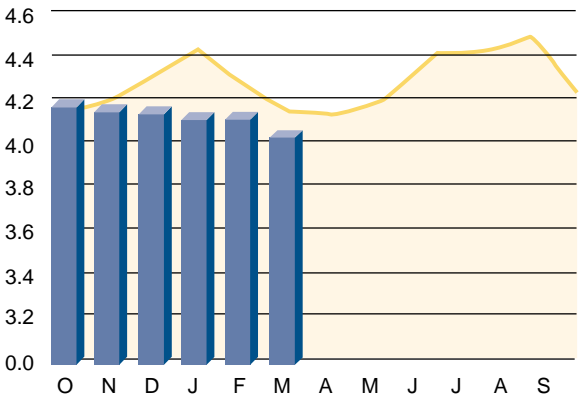
Total Electric Revenue

millions of dollars



Average Revenue

cents per kwh



Tennessee Valley Authority
 400 West Summit Hill Drive
 Knoxville, Tennessee 37902-1401
 02-549 5M 5/02

■ Fiscal Year 2002
 ■ Fiscal Year 2001