

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

2002

Third Quarter Report



Letter From the Chairman

The third quarter of 2002 was a period of solid financial performance for TVA and a time of significant achievements in supporting the National Energy Policy.

TVA reported a net income of \$59 million for the third quarter, an increase of \$84 million from the same period last year. Although revenues for the year-to-date are below those of last year, due largely to the effects of the abnormally mild winter, hot temperatures during the quarter bolstered energy sales by 4.7 percent compared to the same period last year.

To meet the Valley's future power needs while minimizing impacts on air quality, the Board decided to return the Browns Ferry Nuclear Plant Unit 1 to service. The return of Unit 1 will augment our ability to provide affordable, reliable power to the people of the Tennessee Valley and is consistent with the National Energy Policy.

In fulfilling our vital role as public power provider, TVA makes important contributions to the good of the Valley. TVA and three other major transmission providers in the Southeast and Midwest agreed to work together to try to develop broad, seamless transmission service across a major portion of the power grid in the eastern United States. This regional approach supports nationwide efforts to help ensure uniform access, equitable market rules, and quality transmission service.

To promote the development and deployment of new energy technologies that will benefit the nation and improve quality of life, TVA joined in partnership with Oak Ridge National Laboratory, the Department of Energy, and Habitat for Humanity to build "Net Zero Energy" homes. These energy-efficient residences will

produce as much power as they consume, contributing to a cleaner, more secure energy future for homeowners.

TVA is using sound business practices coupled with 21st century technologies to deliver affordable, reliable electric power, a cleaner environment, and a vibrant economy for the people of the Tennessee Valley. Through excellence in business performance and public service, the 13,000 men and women of TVA are generating more for less, for the good of many.



Glenn L. McCullough, Jr.
Chairman

Financial Highlights (millions)

<i>Nine Months Ended June 30</i>	<u>2002</u>	<u>2001</u>
Operating revenues	\$ 4,852	\$ 5,100
Operating expenses	<u>(3,667)</u>	<u>(3,957)</u>
Operating income	1,185	1,143
Other income, net	11	242
Interest expense	<u>(1,073)</u>	<u>(1,241)</u>
Income before loss on project cancellation	123	144
Loss on project cancellation	<u>(150)</u>	<u>-</u>
Net income	\$ (27)	\$ 144

Sales of Electricity (millions - kWh)

<i>Nine Months Ended June 30</i>	<u>2002</u>	<u>2001</u>
Municipalities and cooperatives	90,977	94,038
Industries directly served	20,219	18,250
Federal agencies and other utilities	<u>4,204</u>	<u>6,601</u>
Total sales of electricity	<u>115,400</u>	<u>118,889</u>

Management's Discussion and Analysis

TVA had net income of \$59 million for the third quarter of 2002, compared with a \$25 million loss for the same period last year. For the year-to-date, TVA's net income before loss on project cancellation amounted to \$123 million. The \$27 million net loss for the year is primarily due to a construction project cancellation (see Other Matters, below).

Operating Revenues

Operating revenues for the third quarter were \$1,678 million, compared with \$1,627 million for the same period last year. Fiscal year-to-date operating revenues were \$4,852 million, compared with \$5,100 million for the same period last year. The \$51 million increase for the quarter was primarily due to warmer weather this year with 12 percent more cooling degree days than last year. The significant decline in revenues for year-to-date of \$248 million is the result of extremely milder weather experienced during the first six months of fiscal year 2002 with over 18 percent fewer heating degree days than last year.

Operating Expenses

Operating expenses through the third quarter of 2002 were \$3,667 million, compared with \$3,957 million for last year. Fuel and purchased power expense decreased \$83 million as a result of lower generation. Additionally, depreciation and amortization expenses declined \$396 million, primarily due to accelerated amortization of regulatory assets in 2001 to offset an increase in Other Income (see below). Operating and maintenance expense increased \$178 million, primarily as a result of increased outage and project activities, an increase in workers' compensation expense, and lower yield on pension assets.

Other Income

Other income in the prior year includes 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 \$43 million and \$168 million for the three months and nine months ended June 30, 2002, respectively, as compared with the same periods of 2001. These reductions reflect a lower average interest rate of 6 percent for 2002 as compared with 6.75 percent for 2001 and a lower level of total outstanding debt during fiscal year 2002.

Other Matters

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 megawatts 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.

On May 16, 2002, the TVA Board of Directors authorized TVA Nuclear to take steps to recover and restart Browns Ferry Nuclear Plant Unit 1 in order to meet long-term power requirements. The Board also approved seeking license extensions to operate all three Browns Ferry Units an additional 20 years past the current expiration date of the licenses. The Unit 1 recovery project is expected to add approximately 1,280 megawatts of generation at a cost of \$1.7 billion to \$1.8 billion and take five years to complete.

Balance Sheets (unaudited)

	June 30 2002	September 30 2001
	(MILLIONS)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 371	\$ 339
Accounts receivable	573	720
Inventories (at average cost) and other		
Fuel	179	170
Other	<u>302</u>	<u>272</u>
Total current assets	1,425	1,501
Property, plant, and equipment		
Completed plant	30,851	30,467
Less accumulated depreciation	<u>(11,034)</u>	<u>(10,344)</u>
Net completed plant	19,817	20,123
Construction in progress	1,203	923
Deferred nuclear generating units	4,112	4,110
Nuclear fuel and capital lease assets	<u>511</u>	<u>487</u>
Total property, plant, and equipment	25,643	25,643
Investment funds	613	725
Deferred charges and other assets		
Loans and other long-term receivables	130	124
Debt issue and reacquisition costs	177	140
Other deferred charges	<u>1,407</u>	<u>1,566</u>
Total deferred charges and other assets	1,714	1,830
Total assets	\$ 29,395	\$ 29,699
LIABILITIES AND PROPRIETARY CAPITAL		
Current liabilities		
Accounts payable	\$ 664	\$ 710
Accrued liabilities	185	235
Accrued interest	314	389
Short-term debt	2,247	3,016
Current maturities of long-term debt	<u>1,000</u>	<u>1,984</u>
Total current liabilities	4,410	6,334
Other liabilities	2,668	2,806
Long-term debt		
Public bonds	21,961	20,375
Unamortized discount and other	<u>(418)</u>	<u>(524)</u>
Total long-term debt	21,543	19,851
Proprietary capital		
Appropriation investment	493	508
Retained earnings	257	306
Accumulated other comprehensive income (loss)	<u>24</u>	<u>(106)</u>
Total proprietary capital	774	708
Total liabilities and proprietary capital	\$ 29,395	\$ 29,699

Statements of Income (unaudited)

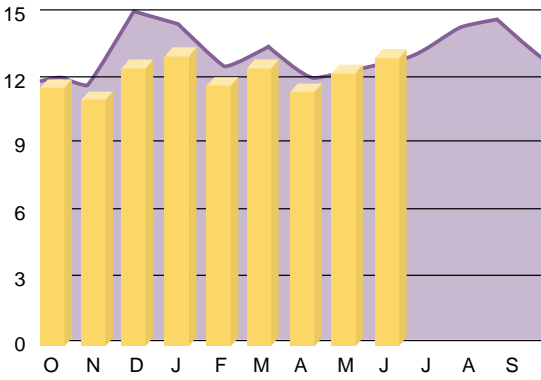
	Three Months Ended June 30		Nine Months Ended June 30	
	2002	2001	2002	2001
	(MILLIONS)		(MILLIONS)	
Operating revenues				
Sales of electricity				
Municipalities and cooperatives	\$ 1,420	\$ 1,352	\$ 4,124	\$ 4,280
Industries directly served	186	175	538	502
Federal agencies and other utilities	48	77	128	255
Other revenue	<u>24</u>	<u>23</u>	<u>62</u>	<u>63</u>
Total operating revenues	1,678	1,627	4,852	5,100
Operating expenses				
Fuel and purchased power	488	472	1,322	1,405
Operating and maintenance	422	382	1,286	1,108
Depreciation and amortization	274	324	814	1,210
Tax-equivalents	<u>82</u>	<u>78</u>	<u>245</u>	<u>234</u>
Total operating expenses	1,266	1,256	3,667	3,957
Operating income	412	371	1,185	1,143
Other income, net	<u>3</u>	<u>3</u>	<u>11</u>	<u>242</u>
Income before interest expense	415	374	1,196	1,385
Interest expense				
Interest on debt	367	393	1,103	1,219
Amortization of debt discount, issue, and reacquisition costs, net	6	22	17	65
Allowance for funds used during construction	<u>(17)</u>	<u>(16)</u>	<u>(47)</u>	<u>(43)</u>
Net interest expense	356	399	1,073	1,241
Income (loss) before loss on project cancellation	59	(25)	123	144
Loss on project cancellation	<u>—</u>	<u>—</u>	<u>(150)</u>	<u>—</u>
Net income (loss)	\$ 59	\$ (25)	\$ (27)	\$ 144

Statements of Cash Flows (unaudited)

	Three Months Ended June 30		Nine Months Ended June 30	
	2002	2001	2002	2001
	(MILLIONS)		(MILLIONS)	
Cash flows from operating activities				
Net income (loss)	\$ 59	\$ (25)	\$ (27)	\$ 144
Net items not requiring cash	292	369	1,040	1,319
Other changes, net	<u>(118)</u>	<u>(109)</u>	<u>(199)</u>	<u>(116)</u>
Net cash provided by operations	233	235	814	1,347
Cash flows from investing activities				
Construction expenditures	(257)	(225)	(889)	(673)
Allowance for funds used during construction	17	16	47	43
Other, net	<u>(5)</u>	<u>(56)</u>	<u>(16)</u>	<u>(107)</u>
Net cash used in investing activities	(245)	(265)	(858)	(737)
Cash flows from financing activities				
Borrowings, net	387	426	(171)	(512)
Proceeds from combustion turbine lease/leaseback	—	—	320	—
Other	<u>(15)</u>	<u>(18)</u>	<u>(73)</u>	<u>(56)</u>
Net cash provided by/(used in) financing activities	372	408	76	(568)
Net change in cash and cash equivalents	\$ 360	\$ 378	\$ 32	\$ 42

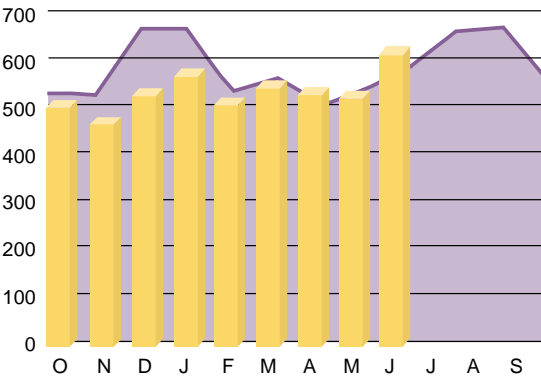
Total TVA Generation

billions of kWh



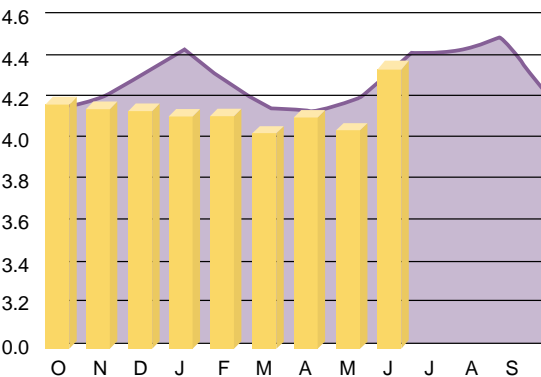
Total Electric Revenue

millions of dollars



Average Revenue

cents per kWh



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■ Fiscal Year 2002
■ Fiscal Year 2001

Cover: Memphis skyline