

TENNESSEE VALLEY AUTHORITY
“Fiscal Year-End Results Conference Call”

Friday, November 16, 2012, 9:30 AM Eastern
Tom Kilgore
John Thomas

OPERATOR: Good morning, and welcome to the Tennessee Valley Authority’s Fiscal Year-end 2012 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today’s presentation there will be an opportunity to ask questions. To ask a question, you may press “star” then “one” on your touchtone phone. To withdraw your question, please press “star” then “two.” Please note this event is being recorded. I would now like to turn the conference over to Mr. John Hoskins, Senior Vice President and Treasurer. Please go ahead.

JOHN HOSKINS: Thank you. Good morning everyone and welcome to the Tennessee Valley Authority’s 2012 fiscal year-end financial review. Leading our discussion today is Tom Kilgore, President and Chief Executive Officer along with John Thomas, TVA’s Chief Financial Officer and Janet Herrin, TVA Executive Vice President of Administrative Services.

Tom will lead off our discussion today with a review of key events from 2012. John will provide an overview of TVA’s financial performance in 2012. Janet will provide an update of TVA’s people and performance. We will then open up the call for a question and answer session.

Before we begin, I would like to point out that today’s press release and TVA’s 2012 annual report on Form 10-K are now available on TVA’s website at www.tva.com. A replay of this call will also be available on TVA’s website for one year.

Today’s discussion may include forward-looking statements that are subject to various risks and uncertainties. Please refer to TVA’s SEC filing, including our most recent annual report on Form 10-K and quarterly report on Form 10-Q, for a discussion of factors that may cause results to differ materially from projections, forecasts, estimates, and expectations.

Now, I’ll turn the call over to TVA’s Chief Executive Officer, Tom Kilgore.

TOM KILGORE: Good morning, everyone, and thank you for joining us on the call. As John said, I’m Tom Kilgore, President and CEO of TVA. As many of you know, I will be retiring soon. This will be my last investor call. The TVA board has found a fine successor for me in Bill Johnson, who will be starting at the first of the year, and I believe shares our vision to be a leader in cleaner and low-energy costs to our service area.

Today I want to cover a few points before John Thomas, our Chief Financial Officer reviews the highlights of our annual performance. 2012 was really quite a year for us. John will give you some more details but I’d like to say it as simply as I can. Compared to last year, we had about \$620 million less in revenue, but ended the year with about \$360 million more in cash. Simply stated, that’s about a one billion dollar favorable swing, due to the efforts of our employees and leadership to react to our challenges. That was a combination of hundreds of projects and creativity of our workforce. We ended the year with strong cash flow, positive net income for reinvestment, and most importantly, no rate increase for 2013. I think by any measure that’s a good result and I appreciate the efforts of all the TVA employees.

One of the things that is really important to us is that we keep our rates affordable. That's what creates and keeps jobs in the Tennessee Valley. While we have some work to do on our industrial rates, our overall customer rates improved in 2012. Our goal is to get back in the top 25% and I think we're on course to do that.

Speaking of jobs, TVA's economic development efforts helped attract almost six billion dollars in capital investment this year in the Valley, and that will keep or retain and create about 48,000 jobs. The quality of our product is pretty important. We are really proud of our thirteenth year in a row of 99.999% reliability, or "five nines" as we call it, because sometimes I get in too big a hurry and leave one of those off. I want to make sure everybody knows it is five nines.

Our fleet performance improved. We had the best year ever for two of our key cleaner-energy sources, nuclear and natural gas. We also lowered our forced-outage rate at our coal plants, and we surpassed our energy efficiency goal for the fifth year in a row. I'd also be remiss if I didn't point out that we added John Sevier combined cycle on time at about \$40 million under budget. We also took stock to get completion of Watts Bar 2 back on track. Our first quarterly update has verified that the construction progress is meeting our estimates as approved by the TVA board in April.

Just to summarize, we had some challenges but the workforce responded in an outstanding way and it was a very good year overall. With that, I'm going to turn it over to John Thomas, who will give you a full report, walk through some of the numbers, and itemize some of the things that I've talked in general about. John?

JOHN THOMAS:

Thank you, Tom. I'll begin today by covering a look at revenue... or sorry, I'll begin with a summary of what impacted our results this year. I've talked throughout the year of the mild winter that we had, one of the mildest in the last 60 years, and you'll see how that impacted it from the revenue perspective. And also I want to show you a slide that indicates that the fourth quarter was actually fairly mild as well.

Overall we've had lower fuel costs, partly because of this mild weather. We were able to run our cheaper-cost generation and optimize overall the fleet, but as well we saw natural gas prices that were low, which helped influence lower purchase-power costs as well. We did have overall lower cash flow as a result of these reduced sales but as Tom has indicated, the workforce rallied behind that and took action to help offset and mitigate the impact of that. Overall, we've made some minor adjustments in terms of our capacity expansion as we've seen slower overall economic growth, and I'll show that in the numbers.

Now I'll begin with... This is a versus budget comparison quarterly for our revenue highlighting that in the first quarter of the year we started out again to see the mild impacts of the weather at \$131 million. Then we got into the winter months in the second quarter and we're roughly \$3 million behind planned. That's when we really increased the efforts around the diet and exercise and the communication to the workforce of the challenges that we had during the year.

The third quarter we were essentially on plan but we didn't make up any ground. Then as we moved into the fourth quarter, typically our strongest sales months in the summer, but you can see we were \$200 million behind. In the late June/early July, you may remember it was very warm but throughout the rest of July and August and September it was fairly mild. Overall we were roughly \$600 million below our plan for revenue and that was really what the organization had to focus on.

When I begin talking about year-over-year results, you can see the total revenue in 2012 was roughly \$11.2 billion versus \$11.8 billion in the previous year; so \$600 million

below what the previous year was. However, you'll see power sales were only about 1% less. Ultimately what that means is rate charged to our customers, the effective rate, that's average revenue divided by sales, was lower. That's what we strive for is to try and keep rates as low as feasible for our customers. This year it happened in a way that we didn't really anticipate and we had to respond to that.

One of the ways that you see us respond is how we manage the fleet overall and how we use our trading floor to optimize the use of purchase power in a favorable purchase power environment. Overall fuel and purchase power costs were approximately \$500 million less than the previous year. Then on the operating and maintenance side you can see that we were \$100,000 million favorable to the previous year.

In the end we ended up, from a net income perspective, with \$100,000 million less in net income but still had \$60 million of net income; again in light of the revenue challenges, I think that's important. We don't focus as much on net income at TVA. We really focus on what our overall cash and operating cash flow is within the business. You can see approximately \$2.6 billion worth of operating cash flow versus \$2.4 for the previous year, so \$137 million of more operating cash flow.

When you look at the investing section you can see \$2.5 billion worth of investing this year versus \$3.1 billion last year. That's \$600 million. I'll remind you that in 2011 we purchased the Magnolia facility, which was roughly \$500 million, so kind of the substantive difference year-over-year in investing section was really the purchase of that natural gas unit; and then from a financing perspective, \$300 million incremental financing versus the previous year of almost \$900. As you would expect, as we've had less investing this year, you would see that then there was less need for financing within the current year as well.

The area where you begin to see some of the significant progress we've made, and where we're really happy with the overall results, is from a plant property and equipment, in terms of what we're investing in our fleet to maintain it as well as what we are doing to provide for future generations, is from a gross PP&E, we added \$1.8 billion worth of investments. If you come down and look at how did our overall financial obligations change relative to that is we ended the year at \$26.9 billion of total debt and other financing obligations versus \$26.6 roughly billion the year before. We added \$253 million worth of overall debt obligations but we invested \$1.8 billion in our assets. I think we're very proud of how that shows the fiscal discipline that flows through our balance sheet management.

More importantly, though, if you look at the cash, and Tom alluded to this, is we ended the year with \$868 million of cash. We had the significant revenue challenges. I'm showing you here where we continued to invest in the fleet but we were able to find ways to position ourselves well for 2013. We ended the year increasing our overall cash and equivalent by \$361 million.

Another way I like to look at this is to take our total financing obligations and net those versus our cash; and you can see that our actual net, debt, and other financing obligations went down by \$100 million year over year. Again, that shows the positive impact of all of the actions we've taken.

Now I'd like to spend a minute and cover in more detail, from a graphic perspective, some of the operational performance that we saw within the year. We aligned our organization and encouraged them through our incentive program to help make the business operate more effectively. We do that across a balanced approach of metrics, not just purely financial metrics. And so, I'd like to cover some of the areas where the organization has performed really well this year.

We'll start with safety. Having our employees come to work and be safe and go home safe so they can return the next day is very important to us. We're very proud of this trend where you can see that for five years in a row, every year we've had a safer work environment and now are well within the top decile in our industry in terms of safe workplace.

Next, then, is the quality of the product that we provide, so the reliability of the electric system. You can see that we have steadily maintained between top quartile and even down to top decile in terms of system reliability, and as Tom mentioned, thirteen years in a row of 99.999% reliability.

Next, we obviously are well aware at TVA of our commitment to the overall Valley in terms of environmental responsibility. This chart shows the reportable environmental event. This was an area where we had noticed that we had an increasing amount of reportable environmental event. You'll notice at the bottom of the screen, where it says "WP Measure." We began highlighting this for the workforce and the significant of this through our incentive program, and you can see that we have seen significant improvement overall, reducing from 53 events in 2010, down to 21 events in 2012. We'll continue to place emphasis on this going forward.

Next then, moving to some of the operational asset performance that Tom mentioned. You can see nuclear plant availability, the highest it's been in the last five or six years, shown here on the chart. We achieved top quartile performance relative to our industry peers at 93% availability of our nuclear fleet.

You can also see, then, in terms of our fossil fleet, so this is our critical, coal and natural gas units. We measure this on a seasonal basis. In the winter months and the hottest summer months when it's most critical to have these assets available to produce low-cost power, you can see that this year was our best year in the last six years. We think it's the best on record that we can find at 2.9%. This is measuring how often they're unavailable and so lower is better in this case. We're almost at top quartile performance relative to our industry peers here too. Overall the fleet performed well this year, and that helped certainly with some of the fuel expense part of the fuel and purchase power being lower.

In summary, from our overall performance objectives: top decile safety performance, continued reduction in reportable environmental events, top quartile nuclear availability, our fossil fleet during the most critical periods were as available as ever. We have an internal measure of net cash flow, which is essentially the way Tom described the approximate billion dollars of favorability we saw this year, and that certainly translates into rates, where they were 10% better than planned and approximately 4.5% or so better than the previous year. Our overall operational performance, I showed you \$100 million favorable to the prior year and almost \$250 million favorable to our plan.

We also have what we call "three year goals". These are more the strategic goals for the organization. You can see reliability is one of those measures. I talked about that, overall an improvement in rates. We think the 10% reduction versus plan and the 5% versus the prior year was certainly very strong performance this year.

Lastly, organizational health, how engaged is the workforce and management relative to giving the right climate for our employees to be as productive as possible. We have seen improvement in that, going from close to bottom quartile to median. However, Tom did mention we still think there is work to do around organizational health. That will be a focus going forward. Overall, throughout a balanced look at the metrics, a very strong year performance-wise at TVA.

I'll spend just a minute talking about the outlook for 2013. We certainly are faced with an uncertain economy with the fiscal cliff issues and how those issues get resolved. We are cautious about what the overall climate will be that we'll be working in. However, we begin the year with a strong cash position so we think that we're well positioned. We'll see how big the challenges are that come at us. We will continue to actively manage spending and balance that with the investment that's needed within our plan.

We do have a favorable interest rate environment and that's certainly important for us, because we do have the need to continue to invest in the Watts Bar 2 facility and the clean air projects that we have going on. We will definitely be in the market for financing. Lastly and certainly very important to us is helping to keep rates as low as feasible.

With that I'll turn it over to Janet Herrin, who is our Executive Vice President of Administrative Services. I think she has some comments.

JANET HERRIN: Thank you, John. You've heard a recap of the highlights and hard spots for the year as TVA worked to carry out its mission. That mission is to serve the people of the Tennessee Valley by providing reliable, low cost power, managing the Tennessee River system, promoting economic development, providing environmental stewardship, and pursuing technological innovation.

To do that, we're working to create a high-performance culture and drive organizational productivity and performance within the company. To achieve and maintain top quartile results, we must stay focused on the six strategic areas of the vision, gauge our performance regularly, and identify and address gaps. We're continuing to set the cultural health bar higher as we strive to have a compensation-fault policy designed to be competitive with the market while motivating performance.

I'll turn it back over to John Hoskins.

JOHN HOPKINS: Thank you. Because we had a public board meeting yesterday and the media were able to cover that meeting, we would like to provide the financial community with the first opportunity to ask questions on today's call. We will then be glad to take questions from any news media on the call. Operator, we are now prepared to open up the call for questions.

OPERATOR: Thank you. We will now begin the question and answer session. To ask a question, you may press "star" then "one" on your touchtone phone. If you are using a speaker phone, please pick up your handset before pressing the keys. To withdraw your question, please press "star" then "two." At this time, we will pause momentarily to assemble our roster. Once again, if you would like to ask a question, it is "star" then "one."

Once more, if you would like to ask a question, please press "star" then one." Our first question comes from Matthew Kinnan of Fidelity Investments.

MATTHEW KINNAN: Hi, it's actually Carrie St. Louis. Hello?

OPERATOR: You may go ahead, ma'am.

CARRIE ST. LOUIS: I just wanted to ask about the outlook for 2013 CAPEX.

JOHN THOMAS: Hey Carrie. This is John Thomas. For 2013, we're looking at roughly two billion dollars' worth of investment that we'll be making. That includes our capacity expansion programs as well as our clean air program.

- CARRIE ST. LOUIS: Okay. Then the trend, you know kind of, is that the new kind of level annually or is it going to be lumpy depending on capacity expansion and environmental?
- JOHN THOMAS: It's a little lumpy. Generally, it's two billion next year. The next year it goes up to a little closer to three. Then it drops down a couple hundred million. We're going to be in the two billion to three billion range out at least through the 2016 time period. As we begin finishing up some of our clean air projects and some of our ash pond remediation projects, you might see that dip down. Of course, we don't know what other kind of regulation will come at that point in time. Generally you'd see between two and three billion, and it's a little lumpy.
- CARRIE ST. LOUIS: Okay. Then could you review your sales forecast for 2013, what you're thinking?
- JOHN THOMAS: Yes, for 2013, we had just normal weather first off with modest economic growth so we're thinking the 1% range overall.
- CARRIE ST. LOUIS: Okay and then, could you give an update on the timing of the Watts Bar completion and then an update also on the Brown Ferry red flag?
- TOM KILGORE: Let me answer that. This is Tom Kilgore. Watts Bar is on track for late 2015 finish. Of course the progress on the construction is going well now. We do have the licensing process that adds some uncertainty towards the last of that, but so far so good on that.
- Then the red finding, we will ask the NRC to come in next year, early in the year, to conduct their supplemental inspection. Hopefully we will be able to reach the end of that red finding, or at least know exactly what we need to do to resolve their concerns. We think we've made progress. We haven't asked them earlier than this because we want to make sure we worked through all the problems that we have identified. We've actually identified more, so we want to make sure that we've identified those and resolved them.
- CARRIE ST. LOUIS: Okay, great. Thank you very much for the call.
- TOM KILGORE: You're welcome.
- OPERATOR: Once more, if you would like to ask a question, please press "star" then "one" on your touchtone phone. Our next question comes from David Flessner of *Chattanooga Times Free Press*.
- DAVID FLESSNER: Good morning. I wondered to add a little more color on the outlook for growth longer term. Is that a slowing period from what you've historically seen, the 1% of the next year? Longer term, are you revising down some of your long-range growth forecast at this point?
- JOHN THOMAS: That's a good question, Dave. We're not. We revised them down a couple of years ago, actually, after we saw the credit crisis. I think we were closer to a 2% long-term growth. We cut that in half. We're in that 1% or 1.1% over the longer term now, but we made that adjustment a few years ago. We realize it will be lumpy as well but that's the average.
- DAVID FLESSNER: In the two billion dollar CAPEX that would be obviously the lowest you've had it in a number of years, right?
- JOHN THOMAS: Yes, I think it's vacillated a bit, but I think that's in the range when you consider from two to three.

- TOM KILGORE: Dave, let me chime in. I think the past years though, we've bought one of these gas projects almost every year for the past two or three years. You can recall those. That adds to our CAPEX and I think we bought three or four of those, just off the top of my head. Obviously the one last year, but before that we've done the same thing.
- DAVID FLESSNER: Is that process over? Are there any other opportunities for gas acquisitions or at this point is that behind you?
- TOM KILGORE: Well I think that's mostly behind us. With gas prices being low, the folks that own those now are more prone to hang on to them and hope that they can sell us the power at economical prices. Unlike before, where those were distressed assets somewhat, I think those folks are hanging on. I will tell you that I think our strategy of balancing our portfolio contributed to our going out and purchasing these while they were somewhat distressed assets, and we did that at good prices.
- JOHN THOMAS: Dave, if I can just clarify too. There are really a couple of ways we look at capital spending. When I talk in the two to three billion dollar range, I'm talking mostly about what we would use as debt funding projects. We do have roughly \$800 million that comes through our rates, which is maintenance capital for our plants. You'd probably see a bigger number, \$800 million or so higher if you add in what goes through rates in our just base maintenance capital.
- DAVID FLESSNER: Does any of that in the next three to four years include expenditures for Bellefonte? What are your plans at this point?
- JOHN THOMAS: Yes, that would be in the debt funded portion. So it was included in the two to three billion I was mentioning.
- DAVID FLESSNER: What is your plan now for Bellefonte? What do you describe as your outlook for completion on that or startup on that?
- TOM KILGORE: I'll let John get my numbers right, Dave, but we have moved to be more conservative on Bellefonte because the board correctly imposed a condition on us based off of lessons learned in the past. We said we're not going to do more than one unit at a time in construction. When we slowed down Watts Bar to be more deliberate about that, we had to slow down Bellefonte to stay consistent with that principle. We're spending around \$100-125 million a year until Watts Bar comes online. That is more conservative but we're still doing the work. We're making progress but making it very deliberately.
- OPERATOR: Our next question comes from Thomas Kim of Tennessee Consolidated Retirement System.
- THOMAS KIM: Hi. I was in and out of the call. Can you talk about your maintenance CAPEX again? Did I hear that right? \$800 million was it, maintenance CAPEX out of two?
- JOHN THOMAS: I don't know about the out of two, but yes, generally in the \$800 million is what we're spending on maintenance capital.
- THOMAS KIM: Thank you. With plans to retire over 2,700 megawatts of coal fire units over the next five years, how is TVA going to replace that capacity?
- JOHN THOMAS: Clearly bringing on Watts Bar 2 will help with that, as well what you've seen is we've had relatively flat capacity while we've been adding some of gas.... Capacity growth in terms of our demand side, but we've been adding these natural gas units, like we added the Magnolia facility a year ago. We added the John Sevier unit this year. So we're addressing that through the gas capacity expansion, the bringing on of Watts Bar 2, and

then our energy efficiency and demand response programs really fill in the balance of that. We're clearly committed as part of our vision to energy efficiency, specifically the demand response being part of our portfolio. That's the other factor.

- THOMAS KIM: A separate question is let's say the U.S. gets downgraded, and I'm sure that your ratings will be affected, is there any collateral that you guys have to put up that will change for your hedging or any kind of activities that you guys do?
- TOM KILGORE: TVA's collateral position would probably change by approximately \$100 million for each notch of rating downgrade.
- THOMAS KIM: Okay. That's it for me.
- JOHN THOMAS: Okay. Great. Thanks, Tom.
- THOMAS KIM: Okay. Thank you.
- OPERATOR: Our next question comes from Mary Powers of Platts.
- MARY POWERS: Hi.
- JOHN THOMAS: Hi, Mary.
- MARY POWERS: Can I clarify something you said yesterday? I had trouble hearing you all on the call and on the board meeting. Were you talking about Sequoyah when you said that the outage could be 77 days but it might be extended to 90?
- TOM KILGORE: Yes, Mary. This is Tom Kilgore. We're currently replacing the steam generators at unit 2. There are four of those. We have an early finish time of 77 days and a late finish of 90. We have the late finish in our budget. The project is susceptible because we're picking up these 350-ton... approximately 350-ton generators and putting them in the top of our containment building. If the wind is up above a certain level or fog comes in, we're susceptible to weather delays. We've kind of budgeted almost the worst case there. We're on target right now I think to finish in the 70s. We could be affected by weather but that's what I meant. It was Sequoyah. We've replaced the same generators for unit 1 already and we've also replaced the steam generators in Watts Bar unit 1. This is the last of those that need to be done. That will affect the outage time for this year. I think I made that remark yesterday. I'll hand off to Bill Johnson and trying to make sure the board knows I've got to accept the responsibility, not Bill, for that outage; and that it will be hard to duplicate this year's outstanding performance on the nuclear production. But it should set us up for future years to be in good shape.
- MARY POWERS: Okay. That's perfect. You're on day like 33 right now, maybe?
- TOM KILGORE: I'd have to pull my Blackberry out and look. Let me see if I can pull that up real quick. That sounds about right because.... Let's see if I can find that. I don't have my report today yet, Mary. That does sound.... we're on late 20s or early 30s in terms of that. We can get somebody out of communications to call you back on it.
- MARY POWERS: I can call Ray. That's not a problem. Okay, great. Thank you.
- JOHN THOMAS: Thanks, Mary.
- OPERATOR: This concludes our question and answer session. I would like to turn the conference back over to John Hoskins for any closing remarks.

JOHN HOSKINS: Thank you. I would like to thank everyone for participating on today's call. Also, if you have any follow-up questions, please contact TVA's Media Relations or Investor Relations at the contact information provided in today's press release. This concludes today's call.

OPERATOR: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.