TENNESSEE VALLEY AUTHORITY
"First Quarter Fiscal Year 2013 Financial Review Conference Call"

February 5, 2013, 9:30 AM ET
President and CEO Bill Johnson
Chief Financial Officer John Thomas

OPERATOR: Good morning, and welcome to the Tennessee Valley Authority's first quarter fiscal year 2013 financial review 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. Please note this event is being recorded.

I would now like to turn the conference over to John Hoskins, Senior Vice President and Treasurer. Please go ahead.

JOHN HOSKINS:
Treasurer

Thank you. Good morning, everyone, and welcome to the Tennessee Valley Authority's first quarter, fiscal year 2013 financial review. Leading our discussion today is our new President and Chief Executive Officer, Bill Johnson, who joined TVA on January 2, and John Thomas, TVA's Chief Financial Officer.

Bill will lead off our discussion with a review of key events during the first quarter of 2013 and his thoughts and outlook on TVA. John will provide an overview of TVA's financial performance during the first quarter of 2013. 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 first quarter 2013 quarterly report on Form 10-Q 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 filings, 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 will turn the call over to TVA's Chief Executive Officer, Bill Johnson.

BILL JOHNSON:
President and CEO

Thanks, John. Good morning, everyone, and thanks for joining us on the call this morning. As John said, we're releasing our first quarter financial results this morning, and this is my first call at TVA. The quarter actually ended before I got here, and I've been here officially for about 35 days, so I'm the new guy in town but one with a long tenure in this business, interacting with stakeholders, investors and the media, including many of you. So, I'm glad to be back.

In those first 35 days, I've been focused on listening and learning across the Valley. I've traveled from one end of the Valley to the other, meeting with customers, public officials and a growing number of our 12,000 employees, and here's what I've observed. We have a hard-working workforce here that puts safety and is hearing the message that achieving excellence requires continuous improvement every day in what we do to keep the lights on here in the Valley. We also have customers, governmental officials and other stakeholders who are ready to partner with us in our public service mission to provide low-cost cleaner energy that helps our communities to have good jobs and a sustainable investment. So it's a solid base, and we're focused on delivering results as a customer-focused organization committed to the values and spirit of public power.

Now, John Thomas, our CFO, will be giving you the details on our financial performance in a minute, but let me give you a few highlights. It was another mild winter in a slow economy, and this contributed to results that look very much like a year ago. We didn't have a rate increase last year, and we had greater time-of-use options for customers, which meant lower rates for many of them.

Electricity sales were relatively flat, and nuclear production was down due to scheduled refueling outages. So fuel costs were up as we met customer demand with more expensive coal and gas. When you take all the puts and takes, the total operating revenue remains essentially on plan.

We had several operational and organizational highlights for the period. First, the Senate confirmed four new members to the TVA Board, ensuring the Board's quorum for operational continuity. We've reduced our carbon emissions by retiring two coal units at John Sevier, the first of 18 units we will close or idle by 2018. We've priced a $1 billion bond issuance at the lowest rate we've ever had for a 30-year issue, and this will effectively save ratepayers about $25 million a year interest cost. The second quarterly update shows that Watts Bar 2 remains on target for completion in late 2015, helping advance our goal to add cleaner power options to our diversified energy portfolio. And in January, we completed a major steam generator replacement at Sequoyah ahead of schedule and under budget.

Looking ahead, we have some very important initiatives, including completing Watts Bar 2 on plan, and on the budget, removing the red finding at Browns Ferry, and bringing Raccoon Mountain back online. We'll also be updating our integrated research plan this year and continuing to balance our energy portfolio. We'll also be complying with environmental controls and doing all of this while keeping rates low.

I've really been pleased with what I've seen here already. I've been pleased with the people, the atmosphere and the leadership and what we can do together to make TVA even a better place. I've told our employees here I came here for a reason, and that is to make a difference every day. I think we can do that, and I look forward to the opportunity.

So thanks for your attention, and now I'll turn it over to John for the financials.

JOHN THOMAS:
Chief Financial Officer

Thank you, Bill. Well, I'll begin with reiterating some of the highlights that Bill has mentioned. Certainly first and foremost in our mind is providing low rates for those in the Tennessee Valley, and we think you'll see that in the first quarter results.

Electricity sales were flat. Operating expenses were up slightly because of planned nuclear refueling outages, including the Sequoyah steam generator replacement. However, excluding nuclear refueling costs, our underlying base O&M expenditures were lower than last year, and we're pleased to see some of the results of the productivity initiatives we put in place in 2012 — higher fuel costs from the change in mix as well as slightly higher natural gas prices, and then we see lower overall interest rates, as we continue to be in a low interest rate environment.

Getting into the actual results themselves, you can see that base revenue came in at $1.5 billion for the quarter. That's slightly down from the $1.6 billion in the first quarter of 2011. You can see that's the $85 million reduction in base revenue, which is primarily from the implementation of our time-of-use rate offering for our customers. So we now have better price signals, we believe, to our customers that over the long term will help drive lower costs within TVA's operations as people understand the relationship between the price of electricity and the cost of electricity. You will see that there's greater differentiation now in our rates between our off-peak periods and even in winter versus summer. So there will be a higher price signal sent to our customers in the summer months when our fleet costs more to run because of the fuel mix.

In terms of the fuel … in terms of the fuel cost recovery, you can see that's where the favorability … or, sorry, the unfavorability in terms of running the higher cost coal generation versus last year when we had more nuclear generation because of no outages last year.

And then in terms of other, although off-system sales is a relatively immaterial part of our overall revenues, during the first quarter this year versus last year, we did see approximately $12 million in terms of higher off-system sales, and so that has impacted. When you're pretty close to — or in line with the prior year for revenues, even a small item like off-system sales can contribute.

Overall you can see power sales flat relative to last year, and the blended rate, when you consider lower base and higher fuel costs, our overall total average rate is in line with last year.

Next, moving into the spending, you can see in line with the increase in fuel and purchased power expenses are higher by $80 million. Our operating and maintenance expense, while overall an increase of 4 percent, or $39 million, I've shown you the detail here, so you can see underneath that, the $73 million higher in terms of outage expense tied to the nuclear refueling outages. But you can also see the $34 million less in operations and maintenance expenses associated with our underlying base spending within the business.

So for the quarter overall, you can see $245 million loss. It's typical to be at a net loss during the first quarter of the year. Last year we were at $173 million. As I had mentioned, the two primary drivers there were the lower base revenue because of the transition to the time-of-use option and the higher O&M spending associated with the outages.

In terms of the cash provided by operating activities, you can see that we were essentially in line with last year. Cash used in investing was down $170 million, two primary drivers there. One was the timing of the purchase of nuclear fuel for our facilities, and so that was lower this year than it was last year by approximately $100 million. As well, last year we were in our construction efforts around our John Sevier combined cycle plant. And so without having that spending, we completed that unit in the spring of last year. You can see $170 million less in overall investing, and then in financing, $168 million, and you'll see that the timing of the financing vary with how we plan for maturities within the year.

A few statistics on the balance sheet. Comparing the end of the first quarter last year to this year, you can see that we've added in plant property and equipment, $1.9 billion. We continue to invest in the asset health and overall, improve the operating condition of our plants. Debt and other financing obligations, higher by approximately $500 million. I talked last year extensively about how we managed our overall cash flow within the year and increased our cash position. We ended the year with around $850 million, and you can see that we ended the first quarter essentially in the same cash position. Although it has been a mild winter, we're still in a very good cash position relative to the current outlook.

And then finally, we like to look at taking our total debt and financing obligations net of cash, and you can see that our overall total debt and other financing obligations less cash is actually better by $250 million.

So in summary, we continue to have economic uncertainty and we'll monitor that throughout the course of the year, as well as the weather this summer will obviously have a big impact on our overall results. We're in a strong cash position coming out of the first half of the winter. We continue to actively manage spending, and we certainly anticipate that this favorable interest rate environment will continue, and our mission is to keep our operating costs as low as feasible and be as efficient as we can to provide low rates for our customers.

So with that, I'll turn it back over to John Hoskins.

JOHN HOSKINS: Thank you, John. We would like to provide the financial community with the first opportunities to ask questions today, and then we will 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: We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you're using a speaker phone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. Once again, it is star, then 1 to ask a question. At this time, we will pause momentarily to assemble our roster.

The first question comes from Matthew Kinnan of Fidelity Investments. Please so ahead.

CARRIE ST. LOUIS:
Fidelity Investments: Hi. I think — it's Carrie St. Louis — I'm registered under the wrong name. I just wanted to ask a couple of questions to Bill. I appreciate the introduction. You commented on the Watts Bar 2 remaining on track for late 2015. I was just wondering if you could comment on the cost side of the equation. Does that still remain on track to your revised estimate?

BILL JOHNSON: Yeah. Good morning, Carrie. We have a schedule that takes us out into the latter part of 2015, and our number to complete all in is $4 [billion] to $4½ billion. I'll tell you, this is getting a lot of scrutiny here by the nuclear folks, by the entire management team, and by the Board. And our close review says that we're on schedule, we're on budget, and so the numbers still look good.

CARRIE ST. LOUIS: Okay. And then if I remember correctly, you guys are going to reassess the next nuclear unit — I believe it's Bellefonte, but I sometimes get confused with the names. That discussion would occur once Watts Bar is completed. Has there been any change in thinking to that plan?

BILL JOHNSON: Well, so what we're doing at Bellefonte is maintaining the asset to make sure that the building and equipment is protected. We're engaging in a level of effort to kind of work on design and engineering, but our focus is on finishing Watts Bar 2.

CARRIE ST. LOUIS: Okay.

BILL JOHNSON: In the meantime, we're going to refresh our integrated resource plan, and so Bellefonte will be part of that discussion. So I think by the end of the year, or at least as we get farther into that IRP process, we'll have a better handle on this question.

CARRIE ST. LOUIS: Okay. And then you did address the red flag at Browns Ferry, and is there any better update in terms of when — timing on resolution, you know, removing that to a different category — would occur?

BILL JOHNSON: I'll tell you what I know. We are going to undergo a 95003 inspection from the NRC, and I expect that will occur sometime in the first half of this year. We have to notify the NRC of our readiness, which I anticipate we will be doing in the next several weeks, and the results of that 95003 inspection, if they're positive, and I certainly expect they will be, will remove the red flag.

CARRIE ST. LOUIS: Okay. All right. And then just lastly, could you just comment on this year's funding outlook and capex budget?

BILL JOHNSON: [Inaudible] Mr. Thomas to help with that one.

JOHN THOMAS: Thank you, yeah. Hey, Carrie, how are you?

CARRIE ST. LOUIS: Good.

JOHN THOMAS: Yeah, we continue to be fluctuating in the $2 [billion] top $3 billion in terms of our outlook for construction expenditures. Really, the variation there is just caused by timing of projects and when we get into the next phase of our clean air environmental spending. So that's kind of in line with what you've seen. For 2013, it's closer to the $2 billion range, but we ramp up clean air construction in the '14, '15 period, so it goes up a little bit.

CARRIE ST. LOUIS: Okay, and then funding for this year?

JOHN THOMAS: Funding — we're still looking at another $2 billion of maturities within the current year, and so we would anticipate being back in the market this year.

CARRIE ST. LOUIS: Okay. Great. All right. Well, good luck, Bill.

BILL JOHNSON: Thank you so much.

OPERATOR: Again, if you have a question, please press star, then 1 on a touchtone phone. The next question comes from Dave Flessner of the *Chattanooga Times Free Press*. Please go ahead.

DAVE FLESSNER: Chattanooga Times Free Press Good morning, and thanks for taking the call. I had a question relative to industrial sales that seemed to be down even more dollar volume. I don't know, how much of it was reflective of the new wholesale pricing you're using, and how much of that — can you explain why industrial sales are declining at this point in the cycle compared to a year ago?

JOHN THOMAS: The primary driver to our industrial sales reduction, Dave, was around USEC. And so USEC is our largest industrial customer, and as you would remember from last year, we had entered into kind of a one-year extension with USEC. We had anticipated losing them as a significant customer in 2012, but we did a one-year extension, but that was reduced sales for USEC over what we saw last year.

DAVE FLESSNER: At this point, you mentioned, Mr. Johnson, that this was similar to what we saw a year ago, shortly after this a year ago. When TVA faced these kind of losses, there was kind of a diet and exercise program. Can you talk about going forth, whether this is — these kind of results so far indicate any need to adjust the fiscal plan, and do you have any type of diet and exercise program for FY 2013?

BILL JOHNSON: Good question, Dave. So as we said earlier, you know, the operating revenues are essentially on plan. We're looking at this very closely. If we have to adjust, we certainly will, because we understand the importance of making these numbers add up at the end of the year. I have a little different view of cost management and cost control. I believe that's something we should be doing all the time, and so our program is going to take a different name here, and it's going to be financial excellence, so we will be focused on the — all the time about being as efficient, as productive, as effective as we can.

DAVE FLESSNER: And finally, with respect to Raccoon Mountain, that one of the — Unit 2, I understand, you brought back on, and there's some more problems now. Can you talk about where you stand in terms of the Raccoon Mountain recovery?

BILL JOHNSON: Yeah, we — you're exactly right. You know, we lost all four units. We reassembled one of the units and ran it for a couple of months or six weeks or so, and then that unit had a problem, so all four units are down. They start coming back, I think, later in the year, because we have to get big pieces and parts forged and machined. There's a possibility that we can restart one of those units in the interim, and that's what we're working on at the moment, but at the moment, all four of them are down.

DAVE FLESSNER: Thank you.

BILL JOHNSON: Thanks, Dave.

OPERATOR: This concludes our question-and-answer session. I would like to turn the conference back over to Bill Johnson, President and Chief Executive Officer, for any closing remarks.

BILL JOHNSON: Thank you. You know, as John Thomas said, the first quarter for us is a transitional quarter, sort of between the seasons, and we'll have a better idea of where we stand later this quarter. But our financial health remains strong, even with the slow economy and the mild weather. We have a good mission here, a good vision here — I would say a great vision to be a national leader in cleaner and low-cost energy. We have an honorable mission of public service. We're focused on some important things here, keeping our customers happy, keeping rates low across the Valley, meeting our responsibility for the environment, partnering to grow jobs and investment in the region, and making sure when the nine million people in the Valley flip that switch, the lights come on.

So thanks for being with us this morning. This concludes our call for today.

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