Financing the Business

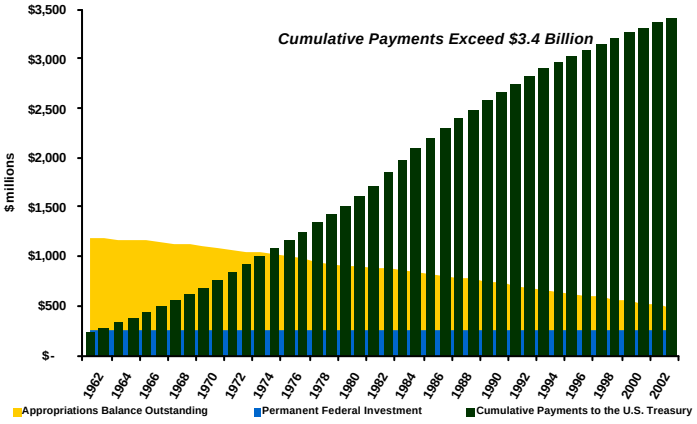
As a self-financed, wholly owned federal corporation and public-power entity, TVA is unique. TVA was created to enhance the quality of life in the Tennessee Valley by providing reliable, affordable electric power, acting as a steward of the region's natural resources and the Tennessee River system, and promoting sustainable economic development. TVA's vision is to help improve the quality of life in the region it serves. As with any government program, TVA's success is measured by its effectiveness in meeting public needs, rather than in creating financial wealth for shareholders.

TVA's ability to fund its mission of public service from its power program without any taxpayer appropriations helps make it a unique company. For more than 40 years, TVA's power program has provided a positive cash flow to taxpayers, as it has been repaying the government's appropriation investment in the TVA power program along with a yearly dividend-like return payment. Through 2002, these payments totaled more than $3.4 billion on the federal government's original investment of $1.4 billion. TVA will pay down the government's original investment in its power system to under $300 million, which will remain as the government's permanent equity in TVA.

2002 Highlights

- **Annual net interest expense was reduced by $204 million.**
- **TVA added almost 1,000 megawatts of additional capacity to its power system to help meet the needs of the Tennessee Valley.**
- **TVA's outstanding balance of bonds and notes was reduced by $120 million, bringing cumulative reduction of bonds and notes to $2.5 billion since the beginning of 1997.**

Power Program Appropriations Repayment:
Cumulative Principal & Dividend-Like Return Payments to the U.S.Treasury

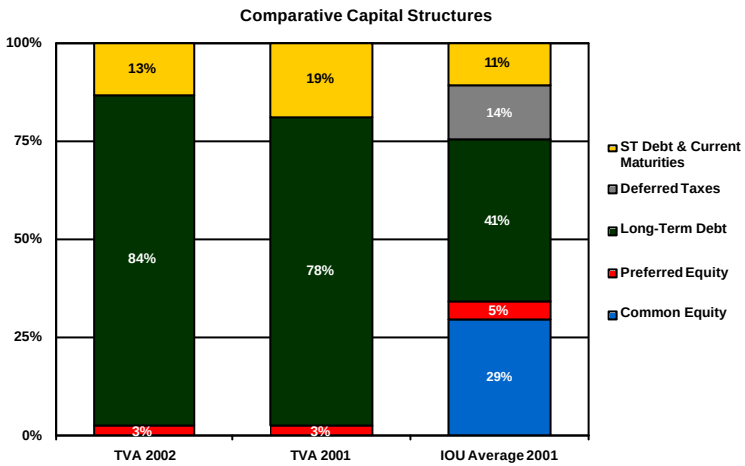


Putting Financial Health in Context

TVA Has a Unique Capital Structure

TVA is financially sound today and is taking steps to ensure that it remains financially sound in the future. TVA's financial performance must be measured in the context of its operating purpose. TVA was created to help bring development to the Tennessee Valley region to generate prosperity for the people it serves, rather than generate a financial return for shareholders.

TVA's capital structure is different from the capital structure of the average IOU. While TVA uses about the same amount of total capital as utilities of similar size, it has more limited means of obtaining these dollars. A typical IOU raises capital through a mixture of common stock, preferred stock, short-term and long-term debt, tax deferrals, and by maximizing profit for reinvestment. TVA is not authorized to issue stock, so it must raise the capital it needs primarily by issuing debt.



Source: EEI 2001 Financial Review; TVA 2002 information statement. Note: "Preferred Equity" for TVA refers to total proprietary capital. Preferred equity for IOUs includes nonredeemable preferred equity, redeemable preferred equity, trust preferred securities, minority interest in equity of consolidated subsidiaries, and other mezzanine equity.

Financial Health Is Measured in Many Different Ways

Rating agencies evaluate all companies within an industry, including TVA, based on the same criteria. These criteria are composed of qualitative and quantitative factors that provide a framework that ensures all salient issues are considered.

Corporate credit analysis usually covers two major areas – business risk and financial risk. Business risk generally includes industry characteristics, competitive position (marketing, technology, efficiency, and regulation), and management. Financial risk includes financial characteristics, financial policy, profitability, capital structure, cash-flow protection, and financial flexibility.

The rating process is not limited to the examination of various financial measures, but requires a broader framework involving a thorough review of business fundamentals, including judgments about the company's competitive position and evaluation of management and its strategies. The analysis of industry characteristics and how a firm is positioned to succeed in that environment establish the financial benchmarks used in the quantitative part of the analysis.

Rating agencies have provided several reasons why TVA's rated bonds receive the highest possible ratings, including the legislation that defines its business charter and authority, its status as a wholly owned federal corporation, its strong operational performance, its solid competitive position, and TVA's integral role in developing the regional economy.

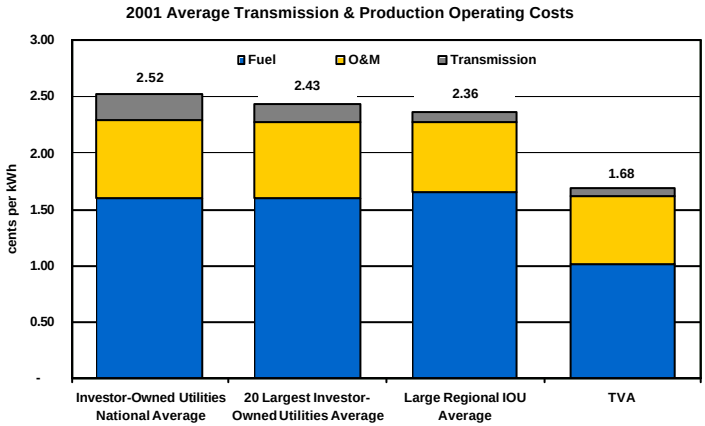
By The Numbers – Comparing TVA to the Industry

While many of the qualitative factors used to rate other utilities also apply to TVA, many of the quantitative factors that are useful in measuring financial performance for an investor-owned utility (e.g., profitability ratios) are not useful in measuring TVA's performance. This is due to the fact that TVA has a different mission and capital structure than an investor-owned utility. Some of the best measures to use in comparing TVA to the industry are operating costs, cash generated from assets, electric-system capitalization, and the average retail price of power.

Operating Costs

TVA's goal is to meet the needs of the Valley over the long term, rather than earn a short-term return on the capital it invests. TVA seeks to keep rates affordable and stable, so it has generally invested in generating assets with higher fixed costs, but with lower operating costs.

The higher front-end fixed costs from constructing these larger generating plants can be paid down over many years. On the other hand, plants requiring less capital to build, such as combustion-turbine facilities, generally have much higher operating costs.

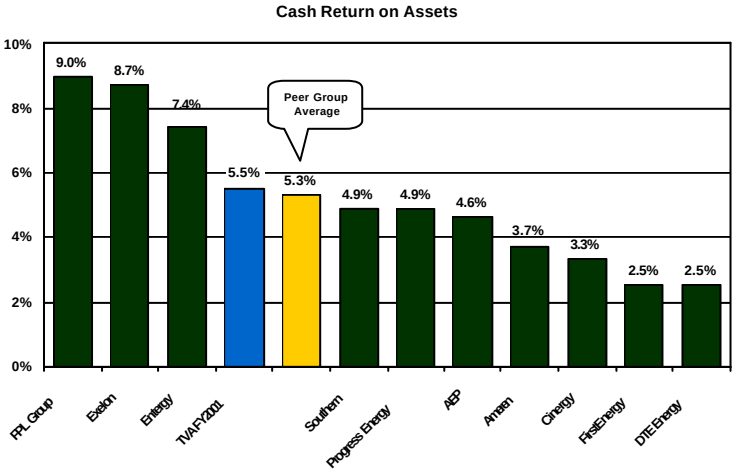


Source: Platt's PowerDat, January 2003 release. Note: Large regional IOUs are those operating primarily within the Eastern Interconnection grid with regulated net generation greater than 50 million megawatt-hours in calendar year 2001. TVA cost information is from the TVA 2001 EIA-412 and the TVA 2001 annual report.

TVA's operating costs are among the lowest in the nation and are more than 30 percent lower than the average of the 20 largest IOUs in the nation. TVA's production costs are low due to several factors, including strong operating performance, optimization of TVA's integrated river and power systems, a diversified generating mix, close proximity to fuel supplies, and a geographic location that has the advantage of dual time zones and moderate temperatures, along with winter and summer peaking periods.

Cash Return on Assets

The amount of cash flow that TVA generates on its assets is comparable to that of the average IOU. Cash return on assets considers the amount of cash provided from operations, less the amount paid out as dividends, divided by the total assets. This measure reflects a company's investment in capital assets, its leverage of available capital, how well it is positioned, and how well management is using cash for daily operations. TVA considers this measure important for making short- and long-term investment decisions.



Source: Company 2001 annual reports. Peer-group average is the average for companies included in this comparison. TVA cash-flow data does not include proceeds from litigation settlement in 2001.

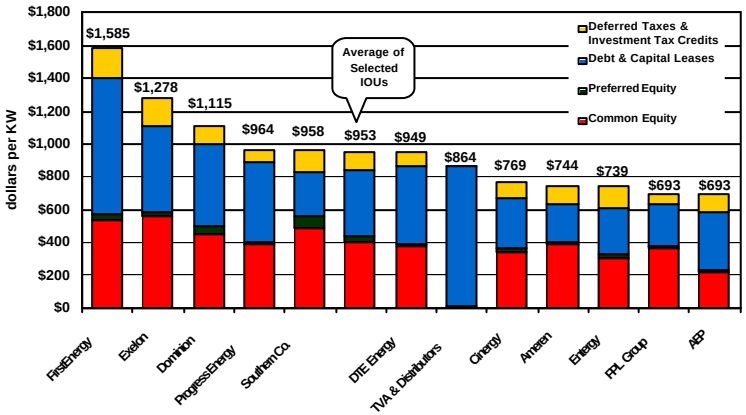
Capital Structure

TVA compares favorably with similarly sized IOUs in terms of power production and the amount of capital needed to build and maintain its power system.

The dollars that TVA has invested in its infrastructure are comparable to the amounts invested by utilities of similar size, such as Southern Company and American Electric Power. TVA has invested in building a diversified and robust power production and delivery infrastructure that includes five operating nuclear units, 59 coal-fired units, 109 hydro units, 72 combustion-turbine units, four pumped-storage units, 19 "green power" facilities, and 17,000 miles of transmission lines. This infrastructure is necessary to serve the growing needs of the commercial and industrial consumers and the eight million residents of the areas served by TVA.

The differences between IOUs and TVA are reflected in the sources of capital they use. While an IOU would try to maximize its net earnings in order to grow its business or pay dividends to stockholders, TVA, as a profit-neutral business entity, generates minimal earnings from its operations. TVA capitalizes its business primarily by issuing debt, but also utilizes other forms of financing, such as lease-leaseback arrangements, when it is economically advantageous to do so.

Electric Power System Market Value Capitalization
Per Kilowatt (KW) of Installed Nameplate Capacity
at September 30, 2002



Sources: TVA 2002 Annual Report, TVA Distributors 2002 Statistical Summary, Company 10-Q Filings & 2001 Annual Reports. Note: Capitalization and capacity data include regulated and nonregulated operations. All components of capitalization included at book value, except common equity, which reflects market value at September 30, 2002. Total capital for each company was adjusted to reflect only capitalization relevant to electric operations.

When all of the sources of capital are considered, TVA actually uses about the same amount of capital to finance its power system as comparably sized utilities. TVA is limited in the ways that it is able to raise capital by its charter, which helps explain why TVA's debt levels are generally higher than that of an IOU, while total capitalization levels are comparable.

Average Retail Price of Power

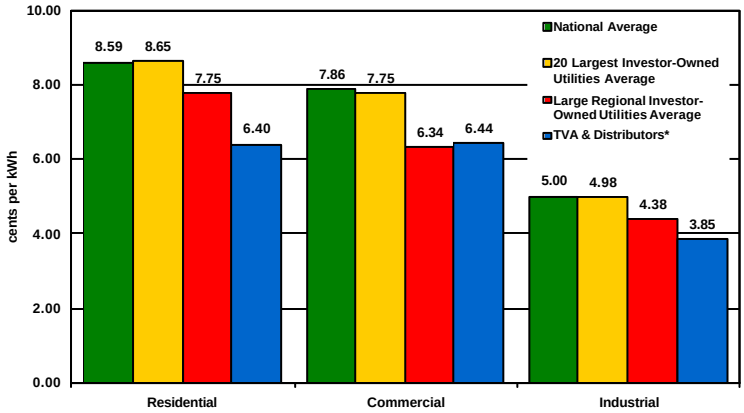
For TVA, the success of the enterprise, both today and tomorrow, is not measured in net income, but in what value it provides to the Valley – affordable, reliable power in the Valley region, stewardship of the Valley's natural resources, and the promotion of regional economic development.

Financing the Business

TVA was created to generate prosperity in the Tennessee Valley region and to provide a societal return for the nation. TVA has successfully carried out its public-power charter for almost 70 years.

One of the requirements of the TVA Act is that TVA sell power "at rates as low as are feasible." The average residential power price in the areas served by distributors of TVA power is 25 percent lower than the national average of rates in areas served by IOUs. These lower rates are reflective of TVA's earnings objective.

2001 Average Price Comparison



Source: Platt's PowerDat - January 2003 release. Note: Large regional IOUs are those operating primarily within the Eastern Interconnection with regulated net generation greater than 50 million megawatt-hours in calendar year 2001. *TVA & Distributors average industrial rate includes customers directly served by TVA. The average industrial rate in the TVA region, not including directly served industrial customers of TVA, is 4.57 cents per kWh. National average includes TVA & Distributors of TVA power.

TVA is dedicated to fulfilling the requirement in the TVA Act to keep rates as low as feasible. While wholesale power prices have increased in many areas of the country in recent years, TVA has increased its power rates only one time in the past 15 years.

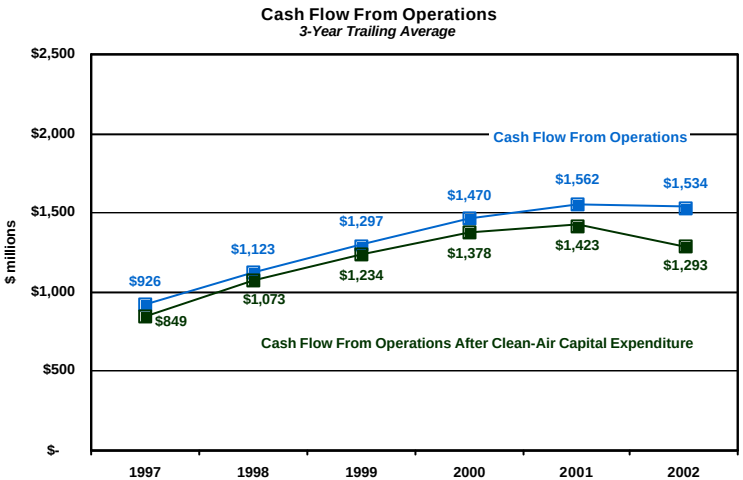
Measuring Financial Health Internally

Some of the best measures for comparing TVA to other utilities are influenced by TVA's unique capital structure and mission. Some of the most important measures of TVA's internal financial health are also related to these factors. These include cash flow from operations, interest coverage, financing obligations compared to capacity, and net interest expense compared to revenue.

Cash Flow from Operations

Having adequate liquidity is essential to maintaining financial health for TVA, as it is for any enterprise. TVA must remain financially healthy to carry out its mission, and for this reason TVA works to mitigate risks as much as possible.

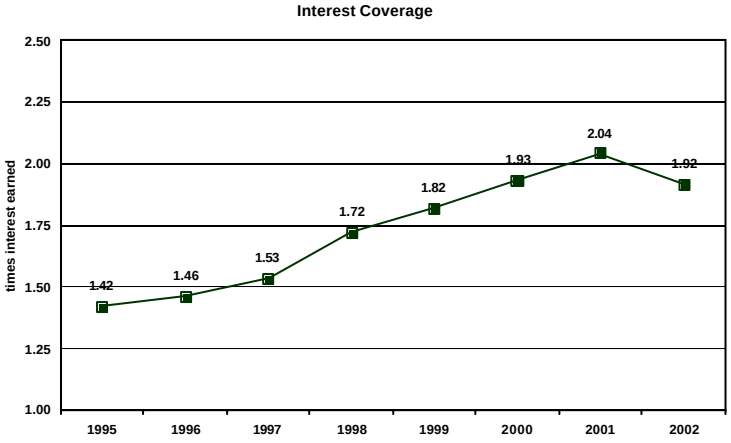
The amount of cash that TVA generates from its operations during the year – operating cash flow – is one of the best ways to measure TVA's ability to meet its short-term obligations. Because power revenues and cash flow are greatly affected from year to year by weather and economic conditions, a three-year average cash flow was used to provide a sound measure of financial health for TVA.



The annual cash flow that TVA generated from its operations was down in 2002, as sales were lower due to exceptionally mild winter weather in the Valley. Cash flow net of clean-air expenditures showed a more substantial decline as clean-air investments have increased significantly. Cash flow has generally been improving over the last several years, enabling TVA to meet the increasing requirements for investment in environmental equipment and clean-air controls, among other things.

Interest Coverage

TVA's ability to service its debt, measured by the degree to which annual cash flow covers its interest obligations, has also improved over the past several years as annual cash flow has generally increased and debt has been reduced. Mild winter weather caused a slight variation from this long-term trend of increasing interest coverage in 2002, as cash flow was affected by lower sales.



TVA cash flow data does not include proceeds from litigation settlement in 2001.

TVA's liquidity is enhanced by several factors other than cash flow that provide further security for investors. The TVA Board of Directors has the ability to adjust rates on a quarterly basis, if needed, even though TVA has only raised rates once in the past 15 years. Additionally, TVA's sound business fundamentals and high credit rating allow ready access to capital markets when needed, while TVA's discount-note program ensures that TVA has the short-term capital it needs to fund daily operations. TVA also maintains access to a $150 million line of credit with the U.S. Treasury.

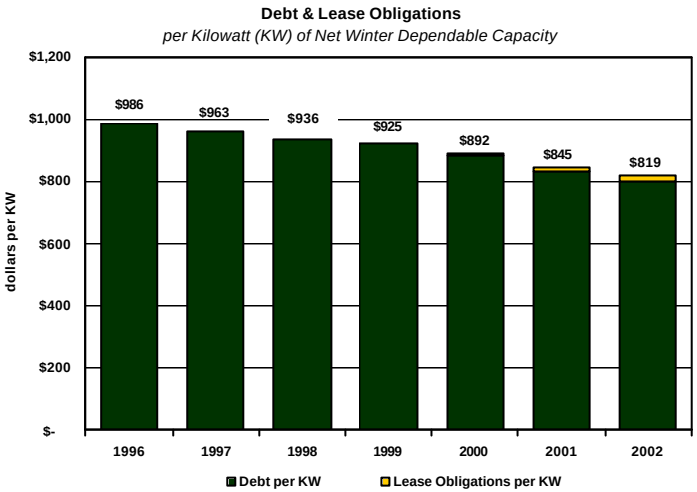
Debt and Lease Obligations

TVA is committed to continuing the trend of debt reduction. The outstanding balance of bonds and notes has been reduced by nearly $2.5 billion since the beginning of 1997. In order to provide for increasing power demand in the Valley while continuing the trend of debt reduction, TVA entered into two lease-leaseback arrangements (through 2002) to provide new generating capacity from 16 combustion turbine units. These transactions have provided TVA with funds to pay down debt or use for other power program purposes.

Under these arrangements, the combustion-turbine generating units are leased to a private investor. TVA then leases the units back under a lease agreement. This provides TVA with cost-effective financing and a greater degree of operational flexibility in meeting the future power needs of the Tennessee Valley.

One advantage of these arrangements is that the risk that the generating units may be obsolete at the end of the leaseback term is shifted to a private investor. Additionally, TVA has negotiated options for early termination of the lease arrangements during the lease period, as well as the option to purchase the units at the end of the period.

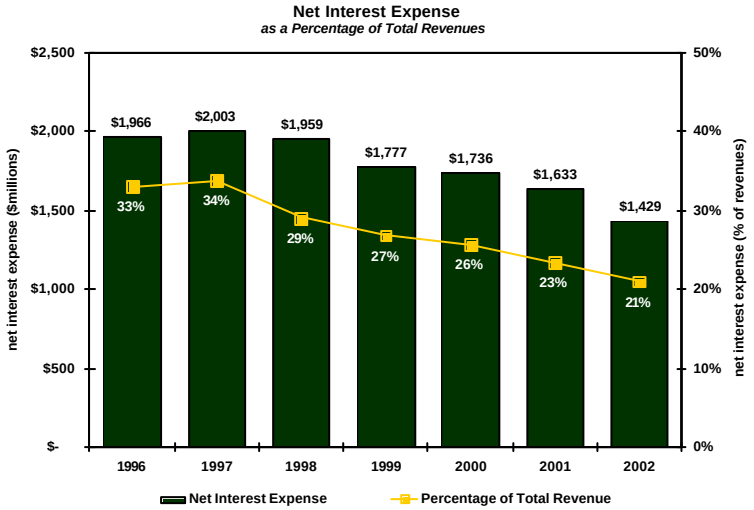
TVA has accounted for and disclosed these transactions consistent with normal business practices and in accordance with generally accepted accounting principles. The lease financing obligations are recorded on TVA's balance sheet as liabilities. This kind of financing is one way TVA keeps costs low to maintain low power prices for its customers.



TVA's combined total debt and lease obligations per kilowatt of capacity have decreased over the past few years. In 1996, TVA had $986 of total debt per kilowatt of system capacity. TVA's total debt and obligations from the lease-leaseback transactions have declined to $819 per kilowatt of system capacity today. This $167 decrease amounts to an average annual decrease of three percent in financing burden.

Net Interest Expense as a Percentage of Revenue

In order to provide power at the lowest feasible rates, TVA is continuing to reduce fixed costs – principally by reducing interest expense. Annual interest expense was more than $2 billion at its peak. This amount has declined by more than 30 percent, to $1.4 billion. In 1997, annual net interest expense as a percentage of total revenues was 34 percent. That figure has been reduced to only 21 percent of revenues for 2002.



Risk Mitigation

TVA has maintained long-term stability through an effective risk-mitigation policy. Exposure to various operational, credit, and market risks is constantly monitored, and TVA only accepts risks where prudent in the normal course of its operations to ensure that it remains financially sound. TVA does not take speculative positions in the market in order to maximize gains, and only uses derivative instruments in a non-speculative way to hedge fuel prices and foreign currency exchange rates, among other things.

TVA also mitigates risk by maintaining a diverse generating mix, consisting of nuclear, hydro, coal, and natural-gas generating sources, and by continually working to decrease the delivered cost of its power, thereby ensuring that its power rates remain competitive.

Looking Forward

As TVA prepares for industry restructuring, it is focusing on effective financial management. A comprehensive look at TVA's financial picture shows that TVA has invested effectively in new generating capacity, transmission-system improvements, and clean-air equipment – all essential elements of TVA's core business and long-term success. Looking forward, TVA will continue to manage its finances effectively while supporting the investments necessary for an affordable, reliable power supply for its customers, improving the quality of life in the Valley region, and fostering sustainable economic growth.