

# Report from Management for the Second Quarter Ended July 31, 2010

CPS Energy, the nation's largest municipally owned utility providing both natural gas and electric service, had a second quarter focused on transition. With the departure of retiring CEO Milton Lee expected September 30, the Board of Trustees completed its selection of a new chief executive officer. Trustees announced on July 22 that Doyle Beneby will lead Greater San Antonio's energy utility. Beneby comes to CPS Energy with more than 25 years in the energy industry with Florida Power and Light, Consumers Energy in Michigan and, most recently, Exelon Power. Beneby's three-year contract began August 1, 2010.

After nearly seven years of planning and construction, CPS Energy received approval for the commercial operation of J.K. Spruce Unit 2 on May 28. The highly efficient 750-megawatt (MW) coal-fired generating unit uses low-sulfur coal from Wyoming and operates with state-of-the-art emissions-control equipment. The project was completed on schedule and on target with its one billion dollar budget and expands the utility's generation capacity to a total of 6,591 MW. An official dedication of the plant is scheduled for September, with final acceptance expected in the fall.

In May, CPS Energy announced a research partnership with the Texas Sustainable Energy Research Institute at the University of Texas at San Antonio. The agreement, predicated upon future rate support, calls for CPS Energy to invest up to \$50 million over 10 years in the institute. The first two years' investment will be \$3.5 million, from funds currently allocated to research and development. Future funding will be developed by the scope of the projects defined by the partnership and subject to annual approval by the CPS Energy Board of Trustees. Research will be tailored to the San Antonio market, its climate and its energy needs/use.

#### In other quarterly highlights, CPS Energy:

- Predicted that, even with the Spring rate increase, customers could anticipate summer bills about \$6 per month less compared to Summer 2009, based on an average monthly use of 1,527 kilowatt hours. The drop was anticipated based on an expected reduction in energy use for the average customer. The National Weather Service predicted a normal summer compared to 2009's summer drought, with 60-plus days of 100 degrees or higher.
- Sustained the most significant damage to its electrical system since 1998, as the result of a sudden and severe thunderstorm with lightning and hail that raked through Greater San Antonio in the early evening hours of June 2, blowing transformers and downing poles and lines. Almost 120,000 electric customers were affected at the height of the storm. By the following morning, power to 70,000 of those had been restored. The remaining customers were reconnected over the next two days, as crews worked neighborhood by neighborhood, street by street, clearing brush and reconnecting lines.
- Continued to develop resources and promotion for Casa Verde SA, the weatherization program developed by CPS Energy and the City of San Antonio. As of July 30, 564 homes/units had been weatherized and more than 3,500 applications received. Of the weatherization programs launched in Texas with federal stimulus funds, San Antonio is second only to Houston for the number of homes/units weatherized and the dollars spent to date.
- Employees donated more than \$25,000 for the purchase of 2,375 box fans for the City of San Antonio Project Cool fan drive. Fans are provided free of charge to elderly citizens and other households in need, to help them keep cool during extreme weather conditions.

**Charles E. Foster**  
Chair, Board of Trustees

**Doyle Beneby**  
Incoming President & CEO

**Milton B. Lee**  
Retiring CEO

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# Interim Report

## Second Quarter Ended July 31, 2010



**Total operating revenues and nonoperating income** of \$589.6 million for the second quarter of fiscal year 2010-11 was \$12.5 million less than the same period last year.

Electric operating revenue was \$541.4 million, reflecting a decrease of \$19.6 million from last year. Contributing to this decrease were lower system fuel recoveries primarily due to lower sales volumes and lower average unit fuel costs. Offsetting the decrease were higher nonfuel recoveries from an increase in the base rate effective in March 2010 and higher off-system nonfuel recoveries. Gas operating revenue of \$35.8 million was higher than last year by \$3.7 million due to higher nonfuel recoveries also as a result of an increase in the base rate effective in March 2010. Additionally, gas fuel recoveries increased as a result of higher distribution gas costs.

Nonoperating income of \$12.5 million was \$3.5 million higher than last year. Of the total variance, interest and other income, combined with the change in fair value, was higher due to a more diversified portfolio and longer maturity dates, resulting in a slightly higher rate of return on investments.

**Total expenses** of \$508.9 million were \$30.8 million, or 5.7%, lower than last year.

- Comprising 33.8% of total expenses, fuel, purchased power and distribution gas costs decreased \$46.4 million to \$172.1 million primarily due to lower average unit fuel costs, resulting from the addition of the new coal unit.
- CPS Energy's operation and maintenance (O&M) expenses of \$80.8 million were \$7.2 million lower than the same period last year due to timing of labor related accruals and operating expenditures.
- South Texas Project (STP 1&2) O&M expenses, including decommissioning, totaled \$39.7 million and were comparable to last year.
- Regulatory assessments, including those charged by the Public Utility Commission of Texas and the Electric Reliability Council of Texas, totaled \$11.1 million and were \$2.5 million higher primarily due to increases in transmission costs of service providers in the Texas market.
- Depreciation and amortization expense of \$76.5 million was \$3.8 million higher primarily as a result of a higher level of plant-in-service. Interest and debt-related expenses of \$40.0 million were \$6.1 million higher than last year primarily as a result of higher debt obligations.
- The recorded payments to the City of San Antonio were \$9.4 million more than the same period last year. The City is paid in advance during the lower-volume months. When the volumes peak later in the year, the calculation self-corrects, and payments correlate appropriately to year-to-date revenues.

**Income (loss) before other changes in fund net assets** of \$80.7 million was \$18.3 million higher than last year's income of \$62.4 million primarily due to higher operating income resulting from revenues associated with the March 2010 base rate increase. Contributed capital of \$3.8 million was \$2.8 million lower than last year. The Change in Fund Net Assets was \$84.5 million compared to \$69.1 million for the same quarter last year. The variance was primarily driven by the increase in net income.

CPS Energy continues to implement strategic initiatives to remain one of the most efficient, reliable and cost-effective energy providers in the country. Customer rates continue to remain among the lowest in Texas and the nation.

**Paula Gold-Williams**  
Chief Financial Officer & Treasurer

	July 31,	
	2010	2009 <sup>1</sup>
<i>(In thousands)</i>		
<b>Assets</b>		
Current assets	\$ 772,134	\$ 1,190,427
Noncurrent assets	1,747,831	1,717,246
Capital assets, net	7,119,369	6,695,377
<b>Total assets</b>	<b>\$ 9,639,334</b>	<b>\$ 9,603,050</b>
<b>Liabilities</b>		
Current liabilities	\$ 605,186	\$ 987,146
Noncurrent liabilities	972,760	962,655
Long-term debt, net	4,762,269	4,481,757
<b>Total liabilities</b>	<b>6,340,215</b>	<b>6,431,558</b>
<b>Fund net assets</b>		
Invested in capital assets, net of related debt	2,379,617	2,393,015
Restricted	578,098	456,396
Unrestricted	341,404	322,081
<b>Total fund net assets</b>	<b>3,299,119</b>	<b>3,171,492</b>
<b>Total liabilities and fund net assets</b>	<b>\$ 9,639,334</b>	<b>\$ 9,603,050</b>

<sup>1</sup> Certain amounts in the prior year have been reclassified to conform to the current-year presentation.

	Quarter Ended		Twelve Months Ended	
	July 2010	July 2009	July 2010	July 2009
<i>(In thousands)</i>				
<b>Revenues</b>				
Electric	\$ 541,352	\$ 560,998	\$ 1,752,492	\$ 1,747,170
Gas	35,828	32,157	247,460	202,943
Total operating revenues	577,180	593,155	1,999,952	1,950,113
Nonoperating income, net	12,454	9,002	46,194	57,306
Total revenues and nonoperating income	589,634	602,157	2,046,146	2,007,419
<b>Expenses</b>				
Fuel, purchased power and distribution gas	172,139	218,532	697,045	708,798
CPS Energy operation and maintenance <sup>1</sup>	80,798	87,992	326,837	350,945
STP O&M, including decommissioning	39,699	38,764	187,700	156,775
Regulatory assessments	11,074	8,543	35,912	36,313
Depreciation and amortization	76,512	72,741	298,256	280,599
Interest and debt-related	40,035	33,925	140,486	135,783
Payments to the City of San Antonio	88,688	79,262	268,447	263,930
Total expenses	508,945	539,759	1,954,683	1,933,143
<b>Income (loss) before other changes in fund net assets</b>	<b>80,689</b>	<b>62,398</b>	<b>91,463</b>	<b>74,276</b>
Other payments to the City of San Antonio	-	-	(9,630)	(11,553)
Contributed capital	3,840	6,664	36,006	26,702
Effect of defined benefit plan funding obligations - STP	-	-	9,788	(29,726)
<b>Change in fund net assets</b>	<b>84,529</b>	<b>69,062</b>	<b>127,627</b>	<b>59,699</b>
<b>Fund net assets - beginning</b>	<b>3,214,590</b>	<b>3,102,430</b>	<b>3,171,492</b>	<b>3,111,793</b>
<b>Fund net assets - ending</b>	<b>\$ 3,299,119</b>	<b>\$ 3,171,492</b>	<b>\$ 3,299,119</b>	<b>\$ 3,171,492</b>

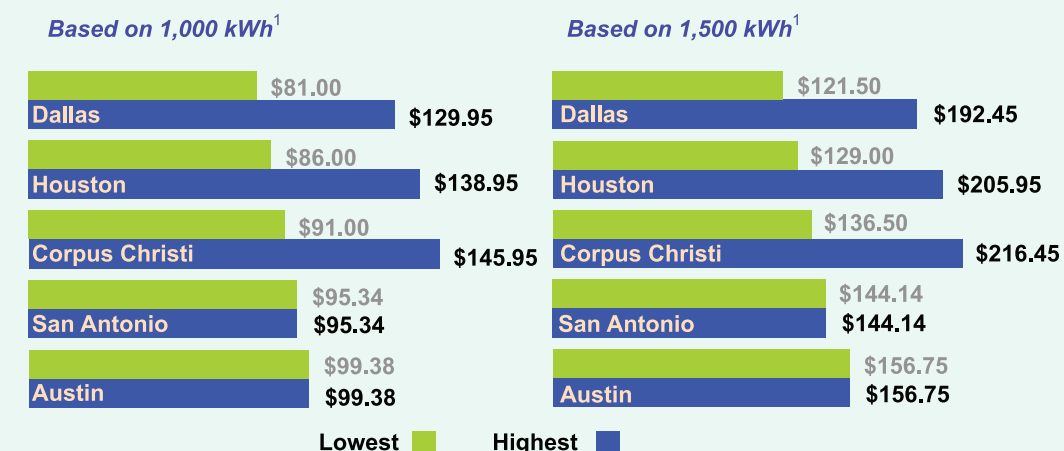
<sup>1</sup> Includes annual OPEB costs, annual pension costs, pollution remediation and Save for Tomorrow Energy Program expenses.

Statistical Highlights - Unaudited

	Quarter Ended		Twelve Months Ended	
	July 2010	July 2009	July 2010	July 2009
<b>ELECTRIC SYSTEM</b>				
System sales (thousands of MWh)	6,097	6,315	20,313	20,142
Off-system sales (thousands of MWh)	1,071	755	3,580	2,646
Total sales (thousands of MWh)	7,168	7,070	23,893	22,788
Customers (average number for period)	712,792	699,636	708,099	695,366
Maximum electric demand (MW)	4,437	4,649	4,625	4,649
<b>GAS SYSTEM</b>				
Sales (MMCF)	3,549	3,365	25,485	20,883
Customers (average number for period)	323,348	321,499	322,402	320,852
<b>GENERATION BY FUEL SOURCE AND OTHER POWER</b>				
Gas and oil	7%	20%	11%	16%
Coal	50%	31%	42%	33%
Nuclear	31%	31%	31%	37%
Purchased power - Renewables	8%	5%	8%	7%
- Other <sup>1</sup>	4%	13%	8%	7%

<sup>1</sup> Other Purchased Power includes 2.8% and 6.3% in the current quarter and current twelve months, respectively, of coal-based generation resulting from precommercial generation testing of Spruce 2.

Residential Electric Bill Comparison



The average usage will vary by city. Prices may vary by season and usage. Average annual usage in San Antonio is 1,207 kWh per month.

Provided for informational purposes only. Source: Public Utility Commission of Texas. Additional information on Texas providers can be found at puc.state.tx.us. Some low offers are applicable only to new customers and may not always reflect all applicable fees.