

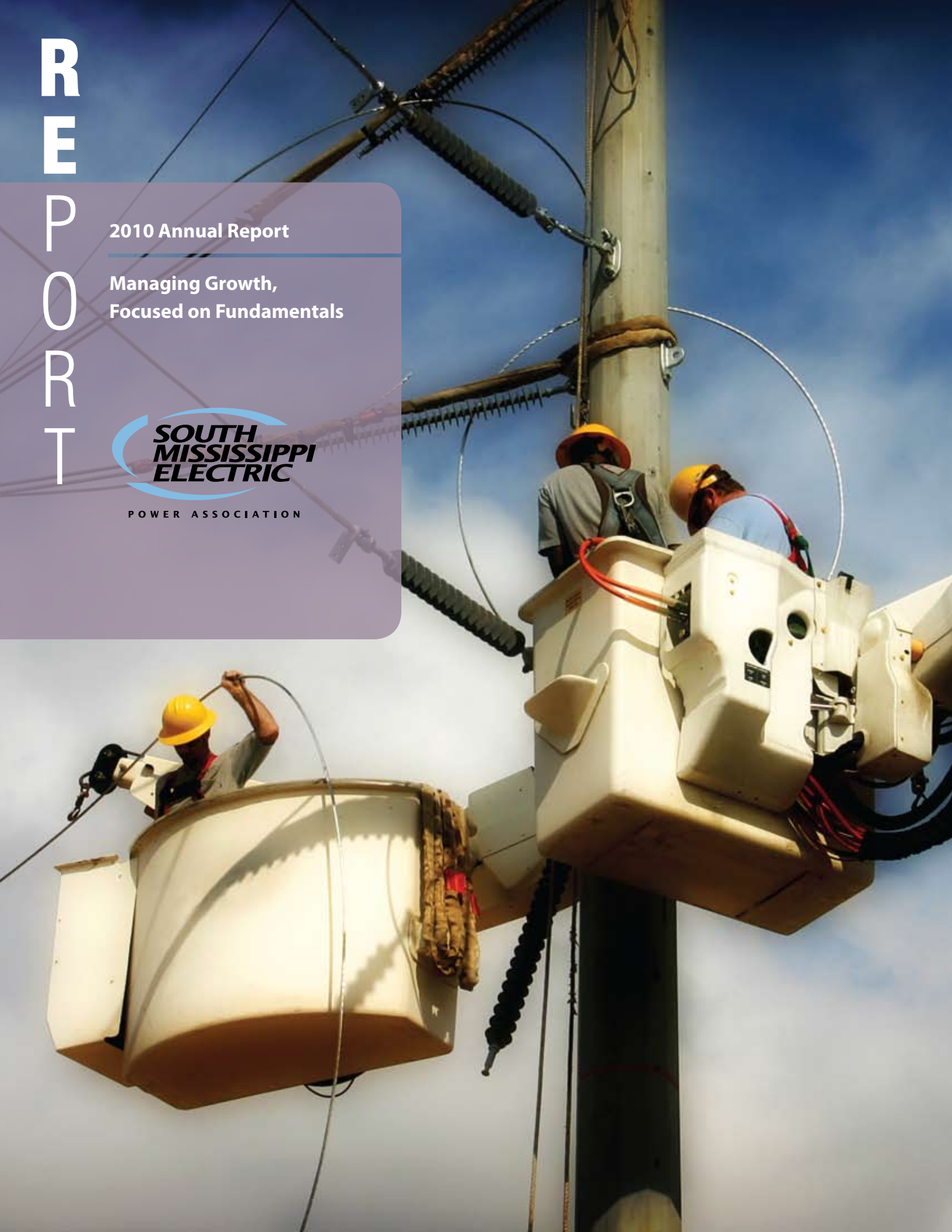
R E P O R T

2010 Annual Report

Managing Growth,
Focused on Fundamentals



POWER ASSOCIATION



FINANCIAL REVIEW

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RESULTS OF OPERATIONS

South Mississippi Electric Power Association provides generation and transmission services to eleven Member distribution cooperatives located in southern and western portions of Mississippi under all-requirements wholesale power contracts that expire in 2045. Members have a menu of rates that contains demand and energy components which are designed to recover the cost of service. A condensed statement of revenues and expenses is as follows:

<i>Condensed Operating Statement, In Millions</i>	2010	2009	2008
Operating Revenues			
Electric Energy Revenues	\$789	\$785	\$733
Other - Deferred Revenue	<14>	<13>	1
Total Operating Revenues	\$775	\$772	\$734
Operating Expenses			
Fuel and Purchased Power	\$571	\$568	\$564
Other Operating Expense	98	90	74
Depreciation and Amortization	37	35	34
Total Operating Expenses	\$706	\$693	\$672
Operating Margin Before Interest & Other	\$69	\$79	\$62
Interest Expense - Net & Other Deductions	\$45	\$50	\$45
Operating Margin	\$24	\$29	\$17
Interest & Other Income	5	1	2
Net Margin	\$29	\$30	\$19

FINANCIAL REVIEW

REVENUES

2010

Electric energy revenues in 2010 increased slightly to \$789 million from the prior year due to an 8.0% increase in total energy sales which was substantially offset by a 7.4% reduction in the average Member rate to 73.51 mills per kWh. The reduction in average Member rates in 2010 is primarily attributable to a five mills per kWh reduction in the energy charge that took effect in December 2009 and a further one mill per kWh reduction effective June 1, 2010.

The increase in total energy sales to 10.7 million megawatt hours (MWh) was influenced by weather-related factors, as a large part of Members' territories experienced a colder winter and warmer summer in 2010 as compared to 2009. Sales to our Members' large power customers increased 12.8% in 2010 from the prior year due to greater economic activity in a number of sectors. Energy sales to non-Members in 2010 comprised less than 1% of total sales. In January 2010, SME recorded a new total system hourly peak of 2,454 MWh, which was 16.6% greater than the prior total system peak in January 2009. SME also set a new summer total system hourly peak of 2,174 MWh in 2010, eclipsing the previous summer peak of 2,087 MWh set in 2007.

The \$14 million reduction in other revenues in 2010 takes into account the net deferral of revenues collected from Members in 2010 that will be matched to expenses and expenditures and accreted to revenues in future periods. In 2010, South Mississippi Electric recognized \$9 million in Power Cost Adjustment (PCA) revenue that had been deferred in 2009 and, at year-end 2010, the Association approved the deferral of \$12 million of PCA revenue to be accreted into revenue in 2011. In addition, the Association deferred \$11 million in revenue and placed cash in that amount in the Power Supply Development Fund (PSDF) for future investment in generation resources. At year-end 2010, the PSDF had a balance of \$26 million, including accrued interest.

2009

Electric energy revenues in 2009 increased \$52 million, or 7.0%, from the prior year due to a 7.9% increase in the average Member rate to 79.39 mills/kWh and a small increase in total energy sales. Member rates in 2009 were formulated to cover the anticipated cost of service in 2009 and to permit the accumulation of funds to meet the Association's future obligations. Energy sales of 9.9 million MWh in 2009 were 0.5% higher than the prior year. Factors that restrained sales growth in 2009 included mild summer weather and decreased energy sales to some commercial and industrial customers due to the recessionary economy.

FUEL AND PURCHASED POWER EXPENSES

Fuel cost varies based upon system load, the availability and efficiency of the generating units being dispatched, and the price of fuel. Purchased power expenses depend upon the demand or capacity costs and the price of fuel for contracted resources, and also upon the current price levels for economy power purchased in the spot market. South Mississippi Electric seeks to minimize the cost of energy supplied to Members through the economic dispatch of available resources and by utilizing bulk power purchases when such costs compare favorably with the variable production cost of owned and contracted resources.

Supplies for a portion of Member load are provided by Mississippi Power Company (MPC) through all-requirements contracts under which MPC supplies the all-requirements needs at certain Member delivery points. The majority of these delivery points are served under a municipal and rural association (MRA) cost-based rate that is subject to Federal Energy Regulatory Commission (FERC) approval. The other MPC delivery points are served under a market-based (MB) wholesale rate. Both rates from MPC include fuel cost adjustments that are revised annually. SME will assume responsibility to supply generation to the MB load on April 1, 2011.

	2010	2009
Coal	\$34.88	\$33.67
Nuclear	8.05	6.45
Natural gas	58.62	75.33

(*) Contracted generation resources refers to Batesville Unit 3 (BU3) and resources under contracts with Louisiana Generating (LA Gen), Union Power Partners (UPP), Southeastern Power Administration (SEPA) and, beginning September 2010, Plum Point Energy Associates (PPEA).

2010

Fuel and purchased power costs of \$571 million in 2010 comprised 81% of total operating expenses and were \$3 million higher than 2009. The increase in cost was attributable to increased volumes of energy generated and purchased that were substantially offset by lower prices for natural gas and purchased power. Fuel costs increased \$26 million in 2010 due to increased generation at owned resources. Net generation at Plant Morrow, a coal-fired generating facility, was 17.1% higher in 2010 than the prior year in order to meet higher energy demand. Fuel and allowance costs for Plant Morrow increased to \$46.18/MWh from \$40.83/MWh in 2009. A substantial portion of the increased fuel cost at Morrow was due to higher freight charges for transportation of coal to the plant.

Purchased power costs decreased \$22 million in 2010 compared to the prior year due to lower prices paid to MPC and other suppliers, which more than offset higher volumes purchased. MPC's MRA and MB contracts had an average cost of \$67.51/MWh, which was 15.2% lower than the prior year.

FINANCIAL REVIEW

Purchased power cost under a contract with LSP Energy LP for Batesville Unit 3 (BU3), a natural gas-fired combined cycle plant, also declined in 2010 due to favorable natural gas costs and improved plant performance. South Mississippi Electric's cost of natural gas, including hedges, decreased to \$7.22/MMBtu in 2010. In September 2010, South Mississippi Electric commenced purchasing 200 MW of capacity and energy from the Plum Point generating facility, a coal-fired power plant in Osceola, Arkansas, under a long term power purchase agreement. The variable energy price of Plum Point is based upon the cost of coal supplied from Wyoming, and the plant is economically dispatched after SME's nuclear and hydro resources, but ahead of gas-fired resources and Plant Morrow.

2009

Fuel and purchased power costs of \$568 million in 2009 comprised 82% of total operating expenses. Fuel and purchased power costs increased \$4 million in 2009 due to a small increase in energy sales and higher purchased power costs under MPC's all-requirements contracts. Overall, fuel costs for owned facilities declined in 2009 as the Association dispatched lower cost resources and took advantage of low cost energy available in bulk power markets. Purchased power costs increased approximately \$31 million in 2009 due to higher volume and a \$35 million increase in the cost of purchases under MPC's all-requirements contracts.

ENERGY SUPPLIES:

Sources of Supply (1000 MWh)	2010	2009	2010 over 2009 Increase/(Decrease)
Total Owned and Contracted Generation (*)	6,447	5,268	1,179
Purchased Power - MPC	3,595	3,298	297
Other Purchased Power	833	1,481	(648)
Total Energy Available	10,875	10,047	828
Energy Losses	169	136	33
Total Sales	10,706	9,911	795

(*) Contracted generation resources refer to BU3 and resources under contract with LA Gen, UPP, SEPA and PPEA.

2010

Operating performance of owned and contracted generation resources in 2010 was generally favorable and the absence of extended forced outages facilitated the economic dispatch of baseload and intermediate units to meet increased demand. During 2010, Plant Morrow operated at an average capacity factor of 69% and Grand Gulf operated at a capacity factor of more than 95%.

	2010	2009
Coal	52.6%	48.6%
Nuclear	15.0%	20.9%
Natural gas	27.4%	23.5%
Hydro	5.0%	7.0%
	100.0%	100.0%

OTHER OPERATING EXPENSES

2010

Other operating expenses are comprised of non-fuel operating and maintenance costs related to generation, transmission expenses and administrative and general costs.

In 2010, other operating expenses increased 8.1% due primarily to higher environmental compliance costs associated with emission allowance costs and an increase in administrative and general expenses. Other operating expenses represented \$9.13/MWh and \$9.12/MWh in 2010 and 2009, respectively.

Interest expense of \$41 million (net of \$3 million in capitalized interest) in 2010 was essentially flat as compared with the prior year. The Association's average cost of debt declined to 4.87% in 2010, which offset the higher amount of debt outstanding during the year.

NON-OPERATING MARGIN

2010

Interest income of approximately \$4 million in 2010 reflects higher interest earning balances deposited in the Rural Utilities Service (RUS) "cushion of credit" program during the year. At year-end 2010, the Association had an approximately \$82 million balance in the cushion of credit, which may be used to meet principal and interest payments on loans from RUS and the Federal Financing Bank (FFB).

FINANCIAL CONDITION

South Mississippi Electric's net margin is calculated after the deduction of deferred revenues discussed above and is collected from Members to cover working capital requirements, capital expenditures not financed by debt and other purposes. In 2009 the Association increased the target annual cash coverage of interest and scheduled principal payments (debt service coverage ratio or DSC) to 1.20 times. In 2010, South Mississippi Electric also established a goal of not permitting the ratio of equity to total assets to fall below 15% while the Association implements a substantial multi-year capital expenditure program. The target debt service coverage ratio and minimum equity ratio are intended to ensure that South Mississippi Electric remains a robust resource for Members and a financially strong partner to

FINANCIAL REVIEW

external stakeholders as the Association's balance sheet grows. In addition, South Mississippi Electric monitors its annual "margins for interest" (MFI) ratio that is defined in the Association's mortgage indenture. A minimum annual MFI ratio of 1.10 is required in order to permit the issuance of secured obligations under the mortgage indenture. The rate schedule for Members that is adopted each year in the Association's annual budget is intended to cover South Mississippi Electric's cost of service and meet target financial ratios. The Association reviews its financial position each month with the Board of Directors, which may make adjustments to Member rate schedules during the year in order to meet financial targets and other objectives.

Financial Ratios

South Mississippi Electric reported net margin of \$29.1 million in 2010 after deduction of deferred revenues, compared with \$30.5 million in 2009. The Association's debt service coverage ratio in 2010 and 2009 was 1.24 and 1.23, respectively. The DSC ratio in 2010 is adjusted to include principal and interest payments to FFB that were accrued and billed for the fourth quarter of 2010 but not paid until January 4, 2011. The equity-to-assets ratio was 15.3% and 15.2% at year-end 2010 and 2009, respectively, and the annual MFI ratio was 1.77 and 1.78 for 2010 and 2009, respectively.

Investment Activities

South Mississippi Electric's total assets increased to \$1,365 million at year-end 2010, \$188 million higher than at year-end 2009. Total utility plant and equipment increased \$158 million net of retirements primarily due to ongoing capital expenditures for major improvements to Plant Morrow's emission control equipment, the Moselle Repower Project and the Extended Power Uprate (EPU) at Grand Gulf Nuclear Station (GGNS). The Morrow scrubber upgrade project is scheduled to be completed in 2011 and the Moselle and EPU projects are scheduled to be completed in 2012. Investments increased \$63 million, attributable to improved performance of the Decommissioning Trust Fund for GGNS and increased investments in the RUS cushion of credit program. The Association plans to utilize a portion of the cushion of credit balance in 2011 to meet scheduled principal and interest payments on RUS and FFB debt as these obligations become due.

Cash Flow From Operations

The growth in assets in 2010 was supported in part by \$123 million in cash from operations, which was \$22 million higher than the prior year. Major components of cash from operations include \$72 million of retained net margins and non-cash charges and \$40 million in working capital movements. The reduction in current assets other than cash provided \$19 million and is largely attributable to the \$26 million decrease in coal inventory that had built up in 2009. Coal inventory at year-end 2010 was sufficient to run Plant Morrow at full capacity for approximately 63 days.

Financing Activities

Long term financing activities during 2010 were comprised of continuing advances under the 'W8' and 'X8' RUS loan contracts for system improvements and the issuance of secured bonds in the capital markets. The Association received a long-term loan advance of approximately \$9 million under the W8 loan agreement during 2010 and expects to draw down the remaining unadvanced balance of \$4 million in the first quarter of 2011. South Mississippi Electric also received a \$20 million loan advance under the X8 loan agreement and had available a remaining unadvanced balance of approximately \$36 million at December 31, 2010 for transmission system improvements. During 2010 South Mississippi Electric closed documentation on the \$63 million 'Z8' loan from RUS for the Morrow scrubber upgrade project and utilization of that financing is expected to occur in 2011. In 2010 RUS also notified the Association that the \$267 million 'Y8' loan for the Moselle Repower Project had been approved and documentation of that facility is expected to close in the first half of 2011, with funding to take place in 2011 and 2012. Altogether, South Mississippi Electric had unadvanced commitments of \$370 million from RUS at December 31, 2010, which the Association intends to utilize over the next three years.

In the fourth quarter of 2010, South Mississippi Electric issued taxable secured bonds to accredited private investors under Regulation D of the Securities Act of 1933. This was the Association's first debt issuance in the taxable bond market and, due to the favorable response from investors, the Association elected to increase the size of the bond issue from \$75 million to \$150 million. The bond funds were initially used to reduce outstanding bank loan balances and in due course the bonds will constitute a portion of the financing required for capital expenditures not financed by RUS.

Liquidity

At year-end 2010 South Mississippi Electric had \$263 million in available commitments under various bank loan commitments, after taking into account used commitments of \$72 million comprised of loan advances outstanding and a letter of credit issued for the Association's account. The bank facilities are for general corporate purposes and for interim financing of capital expenditures, with various final maturities between December 2011 and 2013. SME believes it has adequate access to bank markets to either renew or replace bank credit facilities in due course as appropriate.

Liquidity available to meet the Association's funding requirements is composed of cash on hand and amounts available under the committed bank facilities described above. Bank facilities for interim financing of capital expenditures are available to fund amounts which the Association has expended on specified projects. Unrestricted cash and committed bank facilities available for immediate funding at year-end 2010 represented 99 days coverage of the average daily operating cash expense in 2010.

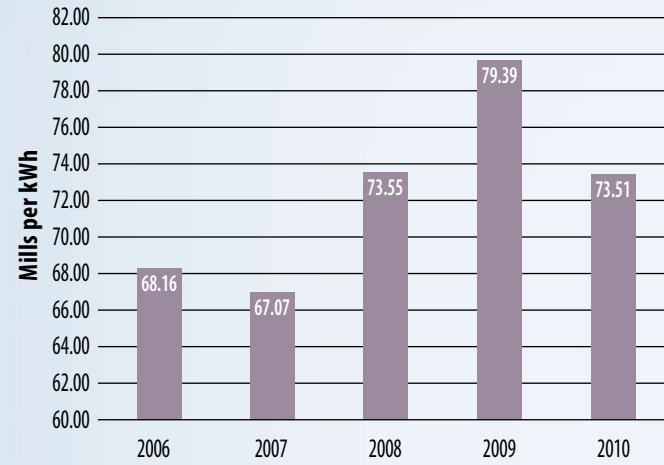
FIVE-YEAR FINANCIAL SUMMARY

<i>In thousands, as of December 31,</i>	2010	<i>2009</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>
Summary of Operations					
Total Operating Revenues	\$775,074	\$772,121	\$733,981	\$667,557	\$636,992
Operating Expenses:					
Purchased Power	\$440,125	\$462,805	\$432,061	\$375,310	\$336,365
Fuel	131,214	105,121	131,692	134,022	139,609
Production	36,441	33,084	22,346	21,564	20,352
Transmission	22,948	21,229	19,463	17,704	15,925
Maintenance	24,949	25,348	21,372	19,540	18,403
Depreciation and Amortization	36,626	35,096	33,911	34,818	43,601
Administrative and General	13,369	10,740	11,233	9,408	8,102
Total Operating Expenses	\$705,672	\$693,423	\$672,078	\$612,366	\$582,357
Operating Margin	\$69,402	\$78,698	\$61,903	\$55,191	\$54,635
Interest Expense	41,138	41,597	43,682	45,281	45,403
Other Deductions	3,665	8,395	1,082	1,816	497
Nonoperating Margin	4,501	1,771	1,939	10,103	2,400
Net Margin	\$29,100	\$30,477	\$19,078	\$18,197	\$11,135
Electric Utility Plant					
In Service - at Cost	\$1,353,096	\$1,325,699	\$1,278,296	\$1,210,950	\$1,210,898
Electric Plant Held for Future Use	44,084	44,084	44,084	44,084	44,084
Construction Work in Process	206,400	75,906	38,679	62,521	37,393
Total	1,603,580	1,445,689	1,361,059	1,317,555	1,292,375
Less Accumulated Depreciation	636,126	602,369	570,508	539,473	528,278
Net Utility Plant	\$967,454	\$843,320	\$790,551	\$778,082	\$764,097
Total Assets					
	\$1,364,840	\$1,176,905	\$1,077,183	\$1,027,289	\$1,017,395
Total Equity and Patronage Capital					
	\$208,337	\$179,237	\$135,486	\$130,820	\$111,485
Energy Sources - MWh					
Generated	3,600,878	3,415,766	3,804,974	4,016,175	4,167,465
Purchased	7,273,772	6,630,968	6,236,184	5,975,289	5,546,728
Total Available for Sale	10,874,650	10,046,734	10,041,158	9,991,464	9,714,193
Energy Sales - MWh					
Member Cooperatives	10,645,623	9,781,030	9,736,312	9,801,007	9,528,089
Non-members	60,284	129,506	126,889	17,167	7,373
Total Sales	10,705,907	9,910,536	9,863,201	9,818,174	9,535,462
Wholesale Rate to Members (mills/kWh)					
	73.51	79.39	73.55	67.07	68.16
Member Annual Peak Demand (*)					
	2,540,824	2,246,441	2,234,963	2,219,508	2,256,836

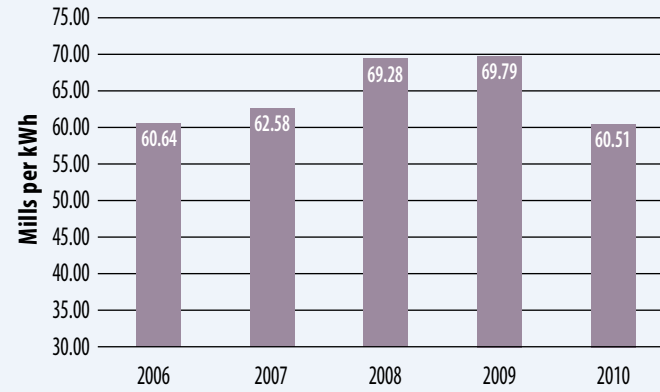
(*) Non-coincident peak in kilowatts

FINANCIAL CHARTS

Wholesale Rate to Members



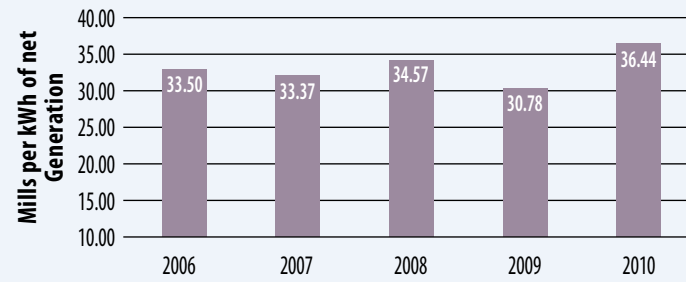
Average Cost of Purchased Power



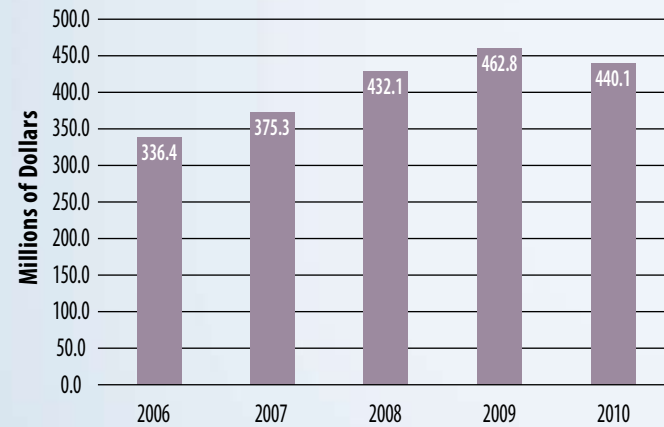
Sales to Members



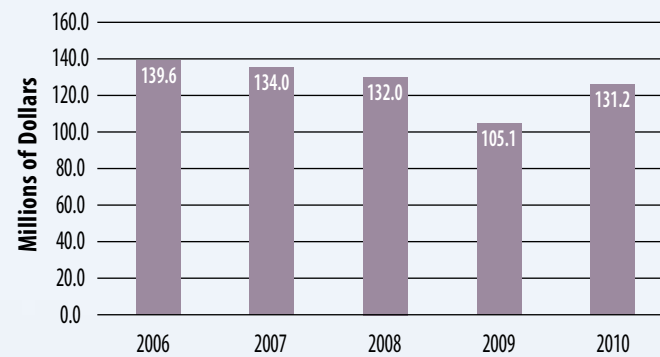
Average Cost of Fuel



Cost of Purchased Power



Cost of Fuel - Owned Generation



REPORT OF INDEPENDENT AUDITORS

The Board of Directors
South Mississippi Electric Power Association

We have audited the accompanying balance sheets of South Mississippi Electric Power Association (SME) as of December 31, 2010 and 2009, and the related statements of revenues, expenses, and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of SME's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of SME's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SME's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SME as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 11, 2011

BALANCE SHEETS

In thousands as of December 31,

Assets**Electric utility plant:**

	2010	2009
In service – at cost	\$1,353,096	\$1,325,699
Electric plant held for future use	44,084	44,084
Construction work in progress	206,400	75,906
	1,603,580	1,445,689
Less accumulated depreciation	636,126	602,369
Net electric utility plant	967,454	843,320

Investments:

Investments in associated organizations and other investments	10,984	11,127
Debt service reserve	4,827	4,739
Decommissioning trust investments	39,449	34,433
Debt service and other prepayments	81,720	23,245
Total investments	136,980	73,544

Current assets:

Cash and cash equivalents	15,938	5,302
Accounts receivable from Members	71,025	64,965
Accounts receivable from others	1,103	56
Inventories (at average cost):		
Coal and other fuels	23,244	48,937
Emission allowances	24,922	33,143
Materials and supplies	24,836	23,366
Other	11,657	4,881
Total current assets	172,725	180,650

Deferred charges	87,681	79,391
Total assets	\$1,364,840	\$1,176,905

BALANCE SHEETS

In thousands as of December 31,

Equities and liabilities**Equities:**

Patronage capital	\$207,802	\$178,702
Donated capital and unrealized gain on decommissioning trust	535	535
Total equities	208,337	179,237

Long-term debt (excluding current maturities)	792,424	703,027
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Accrued decommissioning obligation	50,335	46,823
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Deferred credits and other long-term liabilities	147,093	119,342
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Current liabilities:

Accounts payable	74,026	62,728
Notes payable	35,000	14,300
Accrued interest	9,493	1,209
Other accrued expenses	4,698	3,711
Current maturities of long-term debt	43,434	46,528
Total current liabilities	166,651	128,476

Commitments and contingencies (Notes 3 and 14)

Total equities and liabilities	\$1,364,840	\$1,176,905
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See accompanying notes.

STATEMENTS OF REVENUES, EXPENSES AND PATRONAGE CAPITAL

<i>In thousands for the years ended December 31,</i>	<i>2010</i>	<i>2009</i>
Operating revenues:		
Electric energy revenue from Members	\$768,488	\$763,440
Other electric energy revenue	6,332	8,374
Other – net	254	307
Total operating revenues	775,074	772,121
Operating expenses:		
Fuel	131,214	105,121
Production	36,441	33,084
Purchased power	440,125	462,805
Transmission	22,948	21,229
Administrative and general	13,369	10,740
Maintenance expenses:		
Production	16,612	17,816
Transmission	4,725	4,965
General	3,612	2,567
Depreciation and amortization	36,626	35,096
Total operating expenses	705,672	693,423
Operating margin before interest and other deductions	69,402	78,698
Interest and other deductions:		
Interest	41,138	41,597
Other deductions	3,665	8,395
Total interest and other deductions	44,803	49,992
Operating margin	24,599	28,706
Nonoperating margin:		
Interest income	3,943	1,260
Other	558	511
Total nonoperating margin	4,501	1,771
Net margin	29,100	30,477
Patronage capital at beginning of year	178,702	148,225
Patronage capital at end of year	\$207,802	\$178,702

See accompanying notes.

STATEMENTS OF CASH FLOWS

<i>In thousands for the years ended December 31,</i>	<i>2010</i>	<i>2009</i>
Operating activities		
Net margin	\$29,100	\$30,477
Adjustments necessary to reconcile net margin to net cash provided by operating activities:		
Depreciation, amortization, and decommissioning	43,150	42,984
Gain on sale of assets	(29)	(30)
Other noncash charges	(73)	(37)
Change in current assets	18,561	(43,352)
Change in deferred energy	4,056	(1,936)
Change in current liabilities	21,022	16,695
Change in deferred charges, credits, and other long-term liabilities	7,373	55,943
Net cash provided by operating activities	123,160	100,744
Investing activities		
Proceeds from sale of utility plant	34	51
Purchases of available for sale securities	(10,505)	(9,244)
Proceeds from sale of available for sale securities	11,503	8,650
Change in other investments	(942)	5,122
Electric plant additions	(161,142)	(88,657)
Increase in restricted account to be used for debt payment	(58,475)	(16,877)
Net cash used in investing activities	(219,527)	(100,955)
Financing activities		
Scheduled principal payments on long-term debt	(36,262)	(47,751)
Proceeds from issuance of secured debt	182,545	32,588
Other financing activities – noncurrent	(36,500)	31,911
Net borrowings on notes payable	(2,780)	(14,080)
Net cash provided by financing activities	107,003	2,668
Net change in cash and cash equivalents	10,636	2,457
Cash and cash equivalents at beginning of year	5,302	2,845
Cash and cash equivalents at end of year	\$15,938	\$5,302
Additional cash flow disclosure		
Interest paid	\$31,937	\$38,944

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

South Mississippi Electric Power Association (SME) is a member-owned, not-for-profit electric generation and transmission cooperative that supplies wholesale electricity and other services to its 11 member distribution cooperatives (the Members), which, in turn, provide retail electric service to consumers in certain areas of Mississippi through approximately 411,000 meters. Under long-term wholesale power contracts with each of its Members, SME is obligated to provide all of the power required by the member systems. Financing assistance is provided by the United States Department of Agriculture, Rural Utilities Service (RUS). In addition to being subject to regulation by its own governing board of directors, SME is subject to certain rules and regulations promulgated for rural electric borrowers by RUS. SME maintains its accounting records in accordance with the Federal Energy Regulatory Commission's (FERC) Chart of Accounts, as modified and adopted by RUS. Revenue is generally recognized when power is delivered to its Members. However, as a regulated utility, the methods of allocating costs and revenue to time periods may differ from those principles generally applied to nonregulated companies.

SME owns a 10% undivided interest in a nuclear generating plant known as Grand Gulf Unit 1 (Grand Gulf). System Energy Resources, Inc. (System Energy), a subsidiary of Entergy Corporation (Entergy), owns the remaining 90%, either outright or through leasehold interests. Entergy Operations, also a subsidiary of Entergy, operates the plant along with other nuclear plants owned by Entergy, subject to owner oversight. Grand Gulf commenced commercial operation on July 1, 1985.

2. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

Electric Utility Plant and Depreciation

Electric utility plant is stated at cost, which includes contract work, materials, and direct labor, allowance for funds used during construction, and allocable overhead costs. The cost of electric generating stations and related facilities also includes costs of training and production incurred, less revenue earned, prior to the date of commercial operation.

Depreciation is provided by the straight-line method for the electric utility plant at the following annual composite rates:

Nuclear generation plant	2.84%
Non-nuclear generation plant	0.6% to 3.1%
Transmission plant	2.75%
General plant and transportation equipment	2.0% to 25.0%

At the time that units of the electric utility plant are retired, their original cost and cost of removal, less salvage value, are charged to accumulated

depreciation. Replacements of the electric utility plant involving less than a designated unit of property are charged to maintenance expense. With the exception of turbine inspections, repair and maintenance costs incurred during a planned major maintenance outage are expensed when incurred. Costs associated with turbine inspections are recorded as deferred assets and amortized over the periods between inspections. SME evaluates long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable, based upon expectations of nondiscounted cash flows and operating income.

Allowance for Funds Used During Construction

SME capitalizes interest on certain significant construction and development projects while the projects are in progress. The interest cost capitalized related to debt specifically borrowed for construction and development projects during construction is reflected as a reduction of interest expense. The imputed interest cost related to construction and development projects funded without specific borrowings during construction is reflected as allowance for funds used during construction. During 2010 and 2009, total interest cost amounted to \$42.0 million and \$39.4 million, respectively, with \$3.2 million and \$0.6 million, respectively, capitalized as part of the electric utility plant.

Cost of Decommissioning Nuclear Plant

SME's portion of the estimated decommissioning cost of Grand Gulf (see Note 3) is charged to operating expenses, as it is funded over the estimated service life of the plant. The current operating license received from the Nuclear Regulatory Commission (NRC) terminates in 2024.

Investment Securities

Decommissioning trust investments are categorized as available for sale and are carried at fair value. In 2009, the Board authorized SME to refund or recover any trust investment gains or losses through future rates. In accordance with the regulatory treatment for such decommissioning trust funds, beginning in 2009, SME records a regulatory liability or asset for the amount of unrealized gains or unrealized losses, respectively.

Debt service reserve and other investments are categorized as held to maturity and are carried on the balance sheet at amortized cost. SME has the intent and ability to hold these securities until their estimated maturities but may sell them under certain circumstances.

The primary components that determine a debt security's fair value are its coupon rate, maturity, and credit characteristics. When the fair value of a security falls below amortized cost, an evaluation must be made to determine if the unrealized loss is a temporary or other-than-temporary impairment. Securities that are not deemed to be temporarily impaired are written down to net realizable value by a charge to expense. Premiums

NOTES TO FINANCIAL STATEMENTS

and discounts are amortized and accreted to operations using the level yield method, adjusted for prepayments as applicable. Gains and losses on sales of investment securities are computed using the specific identification method.

Cash and Cash Equivalents

For purposes of reporting cash flows, all temporary investments with original maturities of three months or less are deemed to be cash equivalents.

Emission Allowances

In accordance with the Federal Clean Air Act, SME maintains an allotment of emission allowances. These allowances are carried at cost and are included in inventories in the financial statements. SME carries sufficient emission allowances to meet its current operating needs.

Regulatory Accounting

SME's accounting policies include compliance with Accounting Standards Codification (ASC) No. 980, Regulated Operations. Regulatory assets represent probable future reductions in revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future revenues associated with amounts that are expected to be credited to customers through the ratemaking process. In the event that SME is no longer able to comply with ASC 980 as the result of a change in regulation or effects of competition, SME would be required to recognize the effects of its regulatory assets and liabilities currently in its statements of revenues, expenses, and patronage capital.

Periodically the Board of Directors will set a benchmark power cost adjustment rate to be collected from Members in order to match revenues with actual and forecasted fuel and purchased power costs consistent with the cooperative not-for-profit operation of SME. Material variances between these revenues and costs may cause the recognition of deferred credits or deferred charges from one year to the next.

Additional details regarding regulatory assets and liabilities are included in Notes 7 and 10.

Patronage Capital

The bylaws of SME provide that any excess of revenue over expenses and accumulated prior-year deficits shall be treated as advances of capital by the Member patrons and credited to them on the basis of their patronage.

Income Taxes

SME is exempt from United States income taxes pursuant to Section 501(c)(12) of the Internal Revenue Code, which requires that at least 85% of SME's gross income be derived from its Members.

Derivative Financial Instruments

Derivative and hedge accounting requires that all derivatives be recognized in the balance sheet either as an asset or liability, measured at fair value, unless they meet the normal purchases and sales exemption criteria. Contracts in which SME is effectively hedging the variability of cash flows relate to forecasted natural gas purchases and interest rates. Any gains or losses resulting from the fair value measurement of natural gas hedges are passed through to Members using the mechanisms of the benchmark power cost adjustment rate. Therefore, these derivative instruments are recorded at fair value in the accompanying balance sheets, along with a corresponding offsetting regulatory asset or liability. See Note 11 for the values of the derivatives and the financial statement line item in which the derivatives are reported in the financial statements, and for further disclosure relative to the interest rate hedge.

Electric Energy Revenues

Revenues are recorded in the same month that power is generated and billed. Uncollectible accounts have historically been negligible, so SME does not provide an allowance for doubtful accounts.

Subsequent Events

SME has evaluated subsequent events through March 11, 2011, the date these financial statements were available to be issued.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. COMMITMENTS AND CONTINGENCIES REGARDING GRAND GULF

SME and System Energy are co-licensees and parties to a joint ownership contract that sets forth the rights and obligations of the Grand Gulf owners, with SME generally obligated to pay 10% of all operating and capital costs and entitled to receive 10% of the electricity generated by the plant. SME paid \$41.3 million and \$28.9 million under the contract in 2010 and 2009, respectively.

SME is also responsible for 10% of the estimated cost to decommission Grand Gulf. SME has submitted a formal plan to the NRC that demonstrates that sufficient financial resources will be available at the time it becomes necessary to decommission. In addition, SME received approval from the Internal Revenue Service to establish a "tax-free" grantor trust as a vehicle to fund the estimated decommissioning costs. SME funded \$-0- in 2010

NOTES TO FINANCIAL STATEMENTS

and 2009 and expects to continue funding on an as-needed basis through 2024, based on investment performance and revisions to the estimated decommissioning liability.

SME has recorded an accrued decommissioning obligation. The liability is recorded at the present value of the estimated future outflows, with an accompanying addition to the recorded cost of the long-lived asset, which is then depreciated over its useful life. The accrued obligation has increased from \$44,022,000 to \$46,823,000 to \$50,335,000 at December 31, 2008, 2009, and 2010, respectively, with the entire change in each year attributable to accretion of the liability, which reflects the changes in the present value of the obligation. The accrued decommissioning obligation is based on estimated future cost to remediate the site. Accordingly, as with any estimates, precision of the estimate and unasserted claims can have a material impact on future cost. Due to SME's ability to recover decommissioning costs in rates, SME records a regulatory asset for that portion of decommissioning costs that have not yet been recovered through the ratemaking process. There was no regulatory asset for unrecovered costs at December 31, 2010 and 2009.

SME could also be assessed for other costs or obligations of this facility. Such potential assessments include up to \$11.75 million for each nuclear incident involving licensed reactors, payable at a rate of \$1.75 million per year per incident per nuclear power reactor and \$1.53 million related to property insurance for property damage, decontamination, or premature decommissioning expense involving nuclear generation plants owned by others.

4. ELECTRIC UTILITY PLANT

Electric utility plant consisted of the following:

In thousands as of December 31,	Cost		Accumulated Depreciation	
	2010	2009	2010	2009
Grand Gulf Nuclear	\$447,349	\$446,073	\$280,871	\$268,666
Morrow Steam	235,631	234,768	152,894	150,334
Moselle Steam	36,378	36,817	24,510	24,385
Moselle Gas Turbines	60,679	60,670	14,159	12,340
Silver Creek/Sylvarena Gas Turbines	200,021	200,138	41,141	35,457
Benndale/Paulding Gas Turbines	4,802	4,802	4,464	4,321
Total generating plant	984,860	983,268	518,039	495,503
Transmission plant	290,326	271,814	89,329	82,996
General plant and equipment	76,553	69,260	27,911	23,135
Electric plant leased to others	1,357	1,357	856	845
Electric plant in service	1,353,096	1,325,699	636,135	602,479
Electric plant held for future use	44,084	44,084	–	–
Construction work in process	206,400	75,906	(9)	(110)
Total electric utility plant	\$1,603,580	\$1,445,689	\$636,126	\$602,369

5. INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations are stated at cost and consisted of the following:

In thousands as of December 31,	2010	2009
National Rural Utilities Cooperative Finance Corporation (CFC) Patronage Capital and Term Certificates	\$6,843	\$6,805
Economic Development Loans	525	616
Other	3,616	3,706
	\$10,984	\$11,127

CFC term certificates bear interest at 5.00% to 5.64% and mature in 2070 through 2080.

6. INVESTMENT SECURITIES

The cost or amortized cost and related approximate fair value of investment securities were as follows:

In thousands as of December 31, 2010	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Decommissioning trust:				
Equity mutual funds and exchange-traded funds	\$30,688	\$813	\$4,888	\$26,613
Common stocks	3,823	785	135	4,473
Fixed income mutual funds and exchange-traded funds	6,145	140	5	6,280
U.S. government obligations	2,074	–	–	2,074
Money market funds	9	–	–	9
	\$42,739	\$1,738	\$5,028	\$39,449
Securities to be held to maturity:				
Obligations of states and political subdivisions	\$4,827	\$88	\$ –	\$4,915

In thousands as of December 31, 2009	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Decommissioning trust:				
Equity mutual funds and exchange-traded funds	\$30,674	\$ –	\$8,205	\$22,469
Common stocks	3,854	405	187	4,072
Fixed income mutual funds	3,124	80	2	3,202
U.S. government obligations	4,048	1	–	4,049
Real estate investment trust	96	–	4	92
Money market funds	549	–	–	549
	\$42,345	\$486	\$8,398	\$34,433
Securities to be held to maturity:				
Obligations of states and political subdivisions	\$4,739	\$80	\$ –	\$4,819

NOTES TO FINANCIAL STATEMENTS

Proceeds from sales of securities available for sale were \$11,503,000 in 2010 and \$8,650,000 in 2009. Related gross realized gains and losses in 2010 were \$205,144 and \$201,026, respectively, and in 2009 were \$3,000 and \$122,000, respectively. Fair market value of decommissioning trust investments is based on quoted prices in active markets.

All investment securities to be held to maturity have contractual maturities providing for the securities to mature after five years but less than ten years from December 31, 2010. Actual maturities may differ from nominal maturities because of the borrowers' right to call or prepay obligations.

7. DEFERRED CHARGES (INCLUDING REGULATORY ASSETS)

The following is a summary of amounts recorded as deferred charges, including regulatory assets:

In thousands as of December 31,	2010	2009
Regulatory assets:		
Deferred fuel cost adjustments	\$8,400	\$9,800
Nuclear outage maintenance cost	2,514	937
Postretirement medical benefit regulatory asset	2,988	2,642
Special early retirement program	–	196
Unrealized loss on gas hedges	34,055	22,521
Deferred turbine overhaul cost	3,826	4,865
Unamortized penalties on repriced debt	8,440	10,337
Deferred cost of buyout of Batesville wholesale power contract	10,263	11,289
Unrealized loss on decommissioning trust	2,271	7,417
	72,757	70,004
Other deferred charges:		
Advance payment on Plum Point power purchase agreement	9,874	3,995
Unamortized debt issuance cost	3,186	2,205
Other	1,864	3,187
	\$87,681	\$79,391

Nuclear outage maintenance costs represent SME's 10% share of Grand Gulf's incremental maintenance costs associated with refueling outages. These costs are recorded as a regulatory asset when incurred and are amortized by the straight-line method over the 18 months between outages.

As stated in Note 2, "Summary of Significant Accounting Principles," SME hedges the variability of cash flows related to forecasted natural gas purchases. The fair value of these derivative financial instruments is carried on the balance sheet. Realized gains or losses incurred with these instruments are passed through as part of the wholesale rate to members.

Turbine overhaul costs are recorded as regulatory assets when incurred and amortized into rates during the period between scheduled overhauls, typically five to six years.

SME repriced or refinanced significant amounts of its outstanding debt prior to 1995. As a condition of the transactions, SME paid various prepayment penalties, which are treated as deferred charges to be amortized over the remaining life of the debt. Amortization of all such penalties was \$1,897,000 in 2010 and \$2,091,000 in 2009.

In 2005, SME renegotiated its contract for rights to the output of a 279-megawatt gas-fired, combined-cycle combustion turbine-generator located near Batesville, Mississippi. In so doing, SME paid approximately \$16.0 million to buy-out the remaining 15-year commitment with a wholesale power distributor and now makes capacity payments directly to the power producer, with such payments aggregating approximately \$16.0 million on an annual basis. SME has the right to substantially direct how the generating unit is operated and also is obligated to pay for gas fuel consumed and certain operating and maintenance costs that will vary as the output for SME's usage increases or decreases. The \$16.0 million buy-out payment is amortized over the remaining life of the contract.

During 2006, SME paid \$3.5 million as a refinancing cost under terms of the Plum Point power purchase agreement; this payment was made in lieu of an increase in the reservation payments associated with power purchased under this contract. During 2008, \$0.5 million of preliminary survey costs associated with this power purchase agreement were also transferred into the regulatory asset account. During 2010, SME paid \$6.2 million as its share of costs associated with transmission system interconnections at this facility. These funds will be amortized into rates over the life of the power purchase agreement, which began during 2010 when the related plant came online.

Bond and debt issue costs are being amortized by the straight-line method, which does not differ materially from the interest method, over the term of the related debt. The amortization during the period of construction is capitalized.

During 2009, the SME Board authorized transfer of the balance of unrealized gains and losses in the Grand Gulf Decommissioning Trust Fund from the equity section of the balance sheet to the regulatory liability or asset section of the balance sheet. The balance in the regulatory account will be amortized into rates over the remaining license life of Grand Gulf. The initial transfer into the regulatory asset account during 2009 amounted to approximately \$8.0 million, with \$0.5 million amortized into 2010 and 2009 rates. As a result of unrealized gains during 2010, the balance remaining in the regulatory asset account declined to \$2.3 million at 2010 year-end, due primarily to improved market values of equity securities.

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8. PATRONAGE CAPITAL

Patronage capital consisted of the following:

<i>In thousands as of December 31,</i>	2010	2009
Cumulative margins	\$213,656	\$184,556
Less retirements to date	5,854	5,854
	\$207,802	\$178,702

Under the provisions of debt covenants, until the patronage capital equals or exceeds 40.0% of the total assets of SME, the return to patrons of contributed capital is generally limited to 25.0% of the patronage capital or margins received by SME in the prior calendar year. The patronage capital of SME represents 15.3% and 15.2% of the total assets at December 31, 2010 and 2009, respectively.

9. DEBT

The listing below details SME's revolving credit agreements:

Revolving credit agreements and expiration dates:		
Trustmark National Bank (TNB)	\$20,000,000	June 2012
CoBank	\$175,000,000	June 2012
TNB	\$15,000,000	July 2012
Wells Fargo (formerly Wachovia)	\$15,000,000	October 2012
CoBank	\$25,000,000	July 2013
BancorpSouth	\$10,000,000	September 2013
Bank of America	\$25,000,000	September 2013
National Rural Utilities Cooperative Finance Corporation (CFC)	\$50,000,000	December 2011

These revolving credit agreements bear interest at a variable rate generally based on LIBOR, plus a credit spread. At December 31, 2010, \$61.0 million was outstanding under the revolving credit agreements at variable interest rates up to 3.25%. SME also has an unused letter of credit in the amount of \$10.5 million issued under the CFC credit facility.

On December 31, 2010, SME reclassified the CFC credit facility from long-term debt to the notes payable section of the balance sheet. The commitment matures December 2011.

Long-term debt consisted of the following:

<i>In thousands as of December 31,</i>	2010	2009
Mortgage notes payable in quarterly installments to Federal Financing Bank at interest rates varying from 3.657% to 10.705%, through 2010 to 2035	\$571,953	\$573,359
CoBank notes payable in quarterly installments (variable LIBOR at December 31, 2010 and 2009), maturing in 2012	10,500	11,500
Mortgage notes payable in quarterly installments to CFC (4.95% at December 31, 2010 and 2009), maturing in 2022	2,936	3,144
RUS mortgage notes payable in monthly or quarterly installments (5% to 5.75%), maturing in 2015 through 2030	13,167	14,567
RUS Economic Development notes payable in monthly installments of \$6,852, through July 2016 at 0% interest	445	527
Mortgage notes payable in quarterly installments to CoBank (3.00% at December 31, 2010, 3.25% at December 31, 2009), maturing in 2022	1,192	1,289
1985 Series G Claiborne County, Mississippi, Pollution Control Bonds, variable interest rates (0.75% to 0.80% at December 31, 2010, 1.70% at December 31, 2009), due annually through 2015	19,645	22,645
2009 Gulf Opportunity Zone Bonds, fixed interest to maturity, annual sinking fund payments commence 2011, maturing 2014, 2024, and 2037, 3.25%, 4.70%, and 5.0%, respectively	40,000	36,524
CFC revolving line of credit, expires December 2011	–	50,000
CoBank three-year revolving line, matures June 2012	–	26,000
TNB three-year revolving line, matures July 2012	–	5,000
Wells Fargo three-year revolving line, matures October 2012	–	5,000
First Mortgage Bonds, Series 2010A Bonds – \$40 million at 4.08%, maturing December 9, 2030, \$110 million at 5.40%, maturing December 9, 2040	150,000	–
Bank of America revolving line of credit, matures September 2013	12,000	–
Bancorp South revolving line of credit, matures September 2013	2,500	–
Trustmark National Bank revolving line of credit, matures June 2012	11,520	–
	835,858	749,555
Less current maturities	43,434	46,528
Long-term debt (excluding current maturities)	\$792,424	\$703,027

In 2005, RUS approved an \$88,275,000 guaranteed loan from the Federal Financing Bank (FFB) to SME to finance capital needs. Subsequent to Hurricane Katrina, the RUS also approved funding operating cash flow needs through this loan. The remaining unadvanced commitment was \$4,146,000 and \$13,105,000 as of December 31, 2010 and 2009, respectively. In 2010, RUS approved two loans guaranteed from the FFB in the amounts of \$55,663,000 and \$62,903,000, for capital expenditures. The unadvanced commitments were \$35,553,000 and \$62,903,000, respectively, as of December 31, 2010. Substantially all assets of SME are pledged as collateral on long-term debt.

NOTES TO FINANCIAL STATEMENTS

Approximate annual maturities (scheduled periodic principal payments) of long-term debt for the next five years are as follows (in thousands):

2011	\$43,434
2012	45,672
2013	46,815
2014	48,783
2015	47,805

SME is required by debt compliance covenants to maintain certain financial ratios of interest coverage and annual debt service coverage. SME was in compliance with such requirements at December 31, 2010 and 2009.

10. DEFERRED CREDITS AND OTHER LONG-TERM LIABILITIES (INCLUDING REGULATORY LIABILITIES)

The following is a summary of deferred credits and other long-term liabilities, including regulatory liabilities:

<i>In thousands as of December 31,</i>	2010	2009
Regulatory liabilities:		
Regulatory liability for deferred revenue from power cost adjustments	\$12,177	\$8,121
Regulatory liability – NRECA defined benefit plan premiums	–	1,000
Regulatory liability – Power Supply Development Fund	25,000	14,000
	37,177	23,121
Other deferred credits and long-term liabilities:		
Liability for clean air (CAIR) permits utilized	12,197	10,456
Consumer energy prepayments from members	51,334	52,344
Natural gas hedge liability	33,836	22,287
Reserve for economic development contributions	3,577	2,611
Postretirement benefit obligation (other than pensions)	7,651	7,202
Refundable credit support payments	1,321	1,321
	\$147,093	\$119,342

The liability in 2009 for deferred revenue from power cost adjustments of \$8.1 million was collected from Members during 2009 and recognized as revenue in 2010.

The Power Supply Development Fund (PSDF) was created by the Board of Directors in 2009 with a Board Resolution. The fund was established to facilitate the funding of future capital projects needed to supply the increasing requirements of Members with additional generation sources and to comply with changes in environmental regulation. The \$25.0 million regulatory liability for the PSDF was collected from members in 2009 and 2010, and also includes accrued interest earned on the fund in 2009 and 2010. The PSDF will be amortized back into revenue as costs associated with large generation and environmental projects impact rates, serving to offset cost increases in future periods.

During 2008, SME sold put options for Clean Air Interstate Rule (CAIR) annual NOx allowances. Under terms of the agreement, the counterparty has the unilateral option to sell 600 annual NOx allowances to SME at a certain price during each of 2009, 2010, and 2011. SME entered into this agreement to secure other required annual NOx allowances for the R.D. Morrow generating facility at economical, below-market prices. SME purchased 600 allowances under this agreement in 2009, and 600 allowances during 2010. The liability represents CAIR permits utilized in 2010 and 2009 in the amounts of \$12,197,000 and \$10,456,000, respectively.

The liability for consumer energy prepayments from Members represents amounts paid in advance to SME by its Members for electric energy. The Member prepayment program was established in 2008. During both 2009 and 2010, seven Members participated in the program.

11. FINANCIAL INSTRUMENTS

Derivative Instruments

SME enters into financial hedging arrangements for natural gas used in owned and contracted generating units. SME enters into these hedging arrangements to lessen the impact of natural gas price fluctuations on the cost of service. Under terms of the three agreements, SME is allowed credit exposures of up to \$50.0 million. Physical purchases, actual natural gas usage, and financial hedge positions are considered when calculating amounts due to the counterparty. At December 31, 2010 and 2009, approximately \$33.8 million and \$22.3 million, respectively, of financial hedges were in a net liability position based on fair value of the derivative. At December 31, 2010 and 2009, SME had posted \$5.8 million and \$4.0 million, respectively, as collateral with a counterparty.

As of December 31, 2010, SME has acquired financial hedges to cover approximately 49%, 50%, 25%, and 15% of forecasted exposure to natural gas for years 2011 through 2014, respectively.

During 2009, pursuant to the bankruptcy of Lehman Brothers Special Financing, Inc., and the reissue of the Gulf Opportunity Zone Bonds, the SME Board determined it in the best interest of SME to take steps to terminate the Series 2007 SWAP agreement for the bonds. This hedge was originally entered into in order to hedge interest rate fluctuations for the aforementioned debt. Accordingly, SME accrued a \$4.0 million charge in 2009. This charge was included as interest expense in 2009. SME is continuing to negotiate with the bankruptcy trustee regarding the final settlement of this agreement.

NOTES TO FINANCIAL STATEMENTS

The table below reports the value of the derivatives, and the financial statement line item in which the derivatives are reported in the financial statements:

In thousands as of December 31,	Liability Derivatives			
	2010		2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives not designated as hedging instruments under Statement 133 (ASC 815):				
Natural gas hedge	Deferred credits and other long-term liabilities	\$33,836	Deferred credits and other long-term liabilities	\$22,287
Total derivatives		\$33,836		\$22,287

The effect of derivative instruments on the statements of revenues, expenses, and patronage capital for the years ended December 31, 2010 and 2009, was:

In thousands	Location of Gain (Loss) Recognized in Operating Margin	Amount of Derivative Gain (Loss) Recognized in Operating Margin	
		2010	2009
Natural gas hedges	Fuel expense	\$(30,043)	\$(34,321)
Interest rate hedge	Interest expense	(1,389)	(1,372)

Other Financial Instruments

Cash and cash equivalents, investments, notes payable, and long-term debt are considered financial instruments. The carrying amounts reported in the balance sheets for cash and cash equivalents and for notes payable approximate fair value due to the short maturity of these instruments. The fair values for debt and equity securities are based on quoted market prices when available and the present value of future cash flows discounted at a commensurate market rate. Medium-term CFC obligations, included as a component of securities to be held to maturity, have been estimated based upon published terms of recent issues of comparable instruments since quoted market prices are not available. See Note 5 for additional information. The fair value of investments in associated organizations is not estimable since these instruments must be held by SME and can only be returned to CFC. CFC requires SME to hold these investments as a condition of CFC financing.

The fair values of SME's long-term debt are estimated using discounted cash flow analyses based on SME's current incremental borrowing rates for similar types of borrowing arrangements and rates that would be charged by the applicable issuer, where appropriate.

The carrying amounts and approximate fair values of long-term debt, including current maturities, are as follows at December 31:

In thousands as of December 31,	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FFB	\$571,953	\$637,707	\$573,359	\$701,052
RUS mortgage notes	13,167	12,695	14,567	15,142
Pollution control bonds	19,645	19,645	22,645	22,645
First Mortgage Bonds	150,000	150,000	—	—
Other advances and notes	81,093	81,093	138,984	138,984
	\$835,858	\$901,140	\$749,555	\$877,823

There was no material difference between the contract or notional amount and the estimated fair value of loan commitments. The aggregate estimated fair value amounts presented do not represent the underlying value of SME and may not be indicative of amounts that might ultimately be realized upon disposition or settlement of these assets and liabilities.

12. EMPLOYEE BENEFITS

Managed Care Program

SME provides medical benefits to current employees through a managed care program in which SME makes payments to a trust account controlled by an independent administrator for approved claims and expenses. SME recorded expenses amounting to \$2,713,000 and \$2,420,000 for the years ended December 31, 2010 and 2009, respectively.

Multiemployer Plans

Substantially all of SME's employees participate in the National Rural Electric Cooperative Association (NRECA) retirement programs, which include both a defined benefit pension plan and a defined contribution pension plan. Both plans are qualified under Section 401 and are tax-exempt under Section 501(a) of the Internal Revenue Code. The defined benefit retirement security pension plan is a multiemployer plan available to all member cooperatives of NRECA, but the accumulated benefits and plan assets are not determined or allocated separately by individual employer. SME incurred \$4,410,000 in pension expense for the defined benefit pension plan in 2010 and \$3,041,000 in 2009. SME makes monthly payments to NRECA for the benefit of those employees who voluntarily participate in the 401(k) pension plan. SME expenses the payments as they are accrued, and such 401(k) pension expense amounted to \$775,000 and \$698,000 for 2010 and 2009, respectively.

Postretirement Health Care Benefit Plan

SME sponsors a defined benefit plan that provides certain health insurance benefits to retired employees hired prior to January 1, 1995, and to their eligible dependents. The plan also provides life insurance benefits to a closed group of seven employees who retired prior to January 1, 1990. The estimated costs of these benefits are accrued over the years that the

NOTES TO FINANCIAL STATEMENTS

employees render service. Payments relating to postretirement benefits other than pensions were approximately \$241,000 and \$268,000 in 2010 and 2009, respectively. During 2010 and 2009, retirees paid approximately \$160,000 and \$150,000, respectively, for coverage under the plan.

The Financial Accounting Standards Board (FASB) issued ASC 715, Compensation – Retirement Benefits, which requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its balance sheets.

The following amounts related to the ASC 715 regulatory asset were recognized as components of net periodic postretirement benefit cost in 2010 and 2009:

In thousands as of December 31,	2010	2009
Defined benefit postretirement plan:		
Amortization of net loss	\$62	\$52
Prior service cost	121	116
Total	\$183	\$168

The approximate periodic expense for postretirement benefits, other than pensions, as well as the changes in the accumulated postretirement benefit obligation (APBO), is as follows:

In thousands as of December 31,	2010	2009
Service cost of benefits earned	\$176	\$142
Interest cost on accumulated benefit obligation	406	413
Amortization of prior service cost	121	121
Amortization of actuarial loss	62	52
Net periodic postretirement benefit cost	765	728
Accrued benefit obligation at beginning of year	7,202	6,808
Benefits paid	(332)	(401)
Accrued postretirement benefit obligation at end of year	7,635	7,135
Unrecognized actuarial loss	346	67
Accumulated postretirement benefit obligation	\$7,981	\$7,202

Of the accrued postretirement benefit obligation, \$7.7 million is recorded as an unfunded long term liability, with the remaining \$0.3 million recorded as a current liability. The weighted-average discount rate used in determining the 2010 APBO and the net benefit cost was 5.35% and 5.90%, respectively. The weighted-average discount rate used in determining the 2009 APBO and the net benefit cost was 5.90% and 6.25%, respectively. The assumed health care cost trend rate of increase used in measuring the APBO is 8.5% in 2011, declining to 5.0% by the year 2018. The health care cost trend rate of increase assumption has a significant effect on the APBO and periodic expense. Benefits expected to be paid in 2011–2015 are \$330,000, \$376,000, \$359,000, \$341,000, and \$380,000, respectively. SME expects to fund payments as they become due. The date used to determine the most recent measurements was January 1, 2010. In developing demographic

assumptions, the 1994 Group Annuity Mortality Table, projected to 2010 separately for males and females, was used for healthy lives and the 2006 IRS Disabled Mortality Table was used for disabled lives.

13. FAIR VALUE MEASUREMENTS

SME utilizes the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets and liabilities that SME has the ability to access at the measurement date. Instruments categorized in Level 1 primarily consist of financial instruments such as the investments held in the decommissioning trust.

Level 2 – Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means. Instruments categorized in Level 2 primarily include non-exchange-traded gas hedges.

Level 3 – Unobservable inputs for the asset or liability, including situations in which there is little, if any, market activity for the asset or liability.

The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The lowest level input that is significant to a fair value measurement in its entirety determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment and consideration of factors specific to the asset or liability.

The following table summarizes SME's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009:

In thousands as of December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Decommissioning trust investments (Note 6)	\$39,449	\$39,449	\$ –
Total financial assets	\$39,449	\$39,449	\$ –
Derivatives (Note 11)	\$33,836	\$ –	\$33,836
Total financial liabilities	\$33,836	\$ –	\$33,836

NOTES TO FINANCIAL STATEMENTS

<i>In thousands as of December 31, 2009</i>		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Decommissioning trust investments (Note 6)	\$34,433	\$34,433	\$ -	\$ -
Total financial assets	\$34,433	\$34,433	\$ -	\$ -
Derivatives (Note 11)	\$22,287	\$ -	\$22,287	\$ -
Total financial liabilities	\$22,287	\$ -	\$22,287	\$ -

14. COMMITMENTS AND CONTINGENCIES

In the normal course of business, SME has entered into contractual commitments for coal and coal transportation that extend through the year 2011 and for purchased power that extend through the year 2040. All such contractual costs will be recovered through normal operating revenue.

SME uses natural gas as the fuel for several of its generating units and also purchases power from others that use natural gas as fuel. A portion of natural gas purchases are subject to short-term changes in the market price for gas, and such market prices are quite volatile. In the normal course of operations, SME enters into forward purchase commitments for certain over-the-counter financial swap contracts that extend through the year 2014. All such commitments are expected to be recovered through normal operating revenue.

On July 31, 2006, SME entered into a 30-year power purchase agreement with Plum Point Energy Associates (Plum Point) for the purchase of 200 megawatts of capacity and associated energy out of a nominal 665-megawatt coal-fired electric generation facility that was constructed by Plum Point in Mississippi County, Arkansas. A capacity charge began in 2010 and escalates annually through the initial 30-year term that began on the commercial operation date, which was September 1, 2010. At the end of the initial term, SME has options to extend the contract an additional 10 years at a reduced charge or to purchase 200 megawatts at the then-market value.

On July 27, 2010, SME entered into an agreement with Mississippi Power Company whereby SME acquired the right to purchase an undivided 17.5% ownership interest in an integrated gasification combined cycle (IGCC) generating facility to be located in Kemper County, Mississippi. The closing of this transaction is conditioned upon certain conditions precedent, including but not limited to, the successful negotiation and execution of a joint ownership and operating agreement, receipt of all construction permits and government approvals, SME financing, an independent engineer report acceptable to SME, and transmission and interconnection arrangements acceptable to SME. Closing will not occur

until all conditions have been met. SME is not obligated to fund any project costs until closing.

During the period 2005–2009, inclusive, SME received \$11.8 million from the Federal Emergency Management Agency (FEMA) as partial reimbursement for expenditures incurred as a result of Hurricane Katrina. The initial requests for reimbursement were submitted under the guidance and review of FEMA personnel, and were subsequently reviewed by the Horne Group, LLC, Certified Public Accountants engaged by the Mississippi Emergency Management Agency (MEMA). During 2010, Office of Inspector General personnel performed an audit of certain reimbursements and recommended that FEMA request the return of approximately \$1.5 million that was reimbursed to SME. SME has filed a formal appeal justifying the costs with FEMA. The ultimate resolution of this matter is not known at this time.

In 1998, SME entered into a power purchase agreement with LSP Energy and others for the rights to 279 megawatts of capacity and energy from a combined cycle facility known as “Batesville 3.” The agreement expires in 2015, unless extended by SME for a five-year term. During the past three years, generation from this unit accounted for approximately 9% of SME’s energy supply. In December 2010, Standard & Poor’s lowered its rating on senior secured bonds of Batesville’s owner, following a review of a forecast provided by Batesville’s owner that indicated the owner will not have sufficient funds to make a January 2012 debt service payment.

SME is a defendant in certain litigation incurred in the normal course of business. Management, based on advice of legal counsel, is of the opinion that the ultimate resolution of such litigation will not have a material adverse effect on SME’s financial statements.

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HENRY THOMAS



Henry Thomas, South Mississippi Electric’s general manager from 1985 to 2004, died on January 1, 2011. He was 72.

Under his direction, the Association experienced significant growth and maintained low rates to its eleven Member systems. SME grew from serving 246,996 meters with revenues of \$193 million in 1985 to serving 377,367 meters and generating \$464 million in revenue by 2004.

While at SME, Thomas served on the National Rural Electric Cooperative Association (NRECA) Board of Directors from 1985 to 1988 as well as the NRECA Resolution Committee. In 2005 he received the NRECA Regional Outstanding Service Award. In 2008, SME’s newly constructed Henry Thomas Field Operations Center was named in his honor.

Prior to joining South Mississippi Electric, Thomas spent 16 years with Coast Electric Power Association, serving as a district manager beginning in 1970 and later as general manager until 1985.

HARLAN ROGERS



Dr. Harlan B. Rogers, a 24-year veteran of South Mississippi Electric’s Board of Directors, passed away on September 22 at the age of 81. Dr. Rogers, who served as president of the SME Board from October 2003 until June 2006, was one of only three Board presidents to lead the Association during the past 25 years. In addition, he served as vice president of the SME Board for ten years and was a long-time director of Southern Pine Electric Power Association.

“We have been very fortunate to have had excellent Board leadership for the past 25 years, which has enabled our organization to make great strides in serving our Members,” said Jim Compton, general manager/CEO. “Dr. Rogers’ dedication and contributions to South Mississippi Electric will long be remembered and appreciated.”

EQUAL EMPLOYMENT OPPORTUNITY AND STATEMENT OF NONDISCRIMINATION

South Mississippi Electric is an Equal Opportunity Employer. Employment is based upon personal capabilities and qualifications without regard to race, color, sex, age, religion, national origin, disability, veteran’s status or any other protected characteristic as established by law. This policy applies to all areas of employment including recruitment, hiring, training and development, promotion, transfer, termination, compensation, benefits, and all other conditions and privileges of employment.

All supervisors and managers are responsible for creating an atmosphere free of discrimination. Further, each employee is expected to maintain a productive and non-discriminatory work environment and to treat all colleagues with respect and professionalism.

As a recipient, either directly or indirectly, of federal financial assistance from the Rural Utilities Service, an agency of the U.S. Department of Agriculture (USDA) and from the U.S. Department of Energy, South Mississippi Electric is subject to the provisions of Title VI of the Civil Rights Act of 1964, as amended;

Section 504 of the Rehabilitation Act of 1973, as amended; the Age Discrimination Act of 1975, as amended; and the rules and regulations of the USDA. In accordance with federal law and USDA and Dept. of Energy policy, the Association is prohibited from discriminating on the basis of race, color, national origin, sex, religion, age, or disability.

Any individual, or specific class of individuals, who feel that this Association has subjected them to discrimination may obtain further information about the regulations from and/or file a written complaint with the Association’s Human Resources Director; the USDA, Director of Office of Civil Rights, Room 326-W, Whitten Building, 1400 Independence Avenue, SW, Washington, DC 20250-9410, or call (202) 720-5964 (voice or TDD), or the U.S. Department of Energy, Director of Civil Rights and Diversity, 1000 Independence Avenue, S.W., Washington, D.C. 20585, or call (202) 586-2218 or TDD (202) 586-5329. USDA is an equal opportunity provider and employer. Complaints must be filed within 180 days after the alleged discriminatory action. Confidentiality will be maintained to the extent possible.

OUR MISSION

Deliver the South's best value for safe and reliable electric energy and serve as a common resource for our Member-owners

OUR DAILY RESPONSIBILITY

Knowing and complying with all environmental and regulatory requirements

OUR COMPETITIVE STRENGTHS

- An experienced, skilled work force
- A commitment to employee safety and system reliability
- A long-term contractual relationship with our Member systems
- Financial health, including that of our Members
- Sustained load growth in our Members' service territories
- Long range planning for cost-effective generation resources
- Fuel diversity in generation resources



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