


2004

**ANNUAL
REPORT**

“MEMBERS FIRST”



Homer Electric
Association, Inc.

A Touchstone Energy® Cooperative 

Message from the President and General Manager

Greetings from your Homer Electric Board of Directors and staff. During the past year, our cooperative has continued to grow and improve, bringing reliable electric power to more than 28,000 meters across the Kenai Peninsula. In doing this important work, the cooperative has never lost sight of its new vision statement: **MEMBERS FIRST**.

This vision statement was adopted by the Board of Directors and employees at a strategic planning session last summer in Soldotna. As we discussed various goals and priorities and struggled to put it all into a concise statement, it suddenly became crystal clear. The cooperative exists to serve its members. No matter what the issue might be, the end result must benefit the members of the cooperative.

With the vision statement in mind, the Board of Directors went to the membership in 2004 with a ballot question that was extremely important to the future success of the cooperative. The result was very encouraging, with nearly 80 percent of the voting members approving an amendment to raise the borrowing limit of the cooperative to \$450 million.

The Special Meeting of the Membership also included two other ballot propositions. By overwhelming margins, members voted to elect HEA Board members by district, rather than at large, and institute a term limit of nine years (three, three-year terms) for Directors.

We are pleased to report that Homer Electric is in excellent financial shape. In 2004, the cooperative sold 498.8 million kilowatt hours of electricity. The sales generated 44.5 million dollars in revenue. These figures represent an increase from 2003. Our system continued to grow in 2004, with HEA crews installing 775 new services around the Kenai Peninsula.

During the past year, there were significant economic

developments that will have an impact on Homer Electric. The announcement that Agrium will likely be closing its Nikiski plant in the fall of 2005 was disappointing news. While Agrium's situation is dire, we are pleased to report that Homer Electric's cogen facility, which supplies steam and power to Agrium, will continue to operate after the plant closes. The cogen's turbine will continue to produce 40 megawatts of low cost power that will be used by HEA members.

While Agrium is preparing for a possible shutdown, Northern Dynasty Minerals, Inc. (NDM) is busy exploring a gold deposit on the west side of Cook Inlet. Homer Electric has been selected by NDM as the power provider for the Pebble Project and feasibility studies are underway to determine the best source of power for the proposed mine.

Homer Electric has made no long term financial commitments, but we will continue to negotiate with NDM and do what is best for the members of the cooperative.



In 2004, Homer Electric was successful in its deliberations with the Regulatory Commission of Alaska (RCA). After a long and complicated process, Homer Electric completed a rate case before the RCA which began in 2000. The result was favorable to HEA, allowing a streamlined ratemaking methodology that will benefit our members.

Also, the Chugach Electric Association (CEA) appeal of a 2001 CEA rate case decision was rejected in Superior Court. The result saves HEA around \$900,000 per year.

The Board of Directors is extremely pleased with the progress made this past year. Our employees continue to do an excellent job; whether they are restoring power during a storm or working with a member on a billing issue, the guiding principle for employees at Homer Electric is **MEMBERS FIRST**.

We look forward to the progress employees, members and the communities on the Kenai Peninsula are making on behalf of us all.

2004 Year in Review

Your local electric cooperative had a busy year in 2004. Some of the year's highlights include a favorable decision from the Regulatory Commission of Alaska (RCA) regarding a rate case, the joint initiative to review the feasibility of a power development plan for the Pebble Gold/Copper Project, member approval of three special ballot propositions, installation of new generators that will serve Seldovia and the villages of Port Graham and Nanwalek, continued Spruce Bark Beetle clearing efforts, implementation of an Automated Meter Reading pilot program and exploring the options of wind power generation. The following is a brief summary of these major projects and events that occurred in 2004.

RCA Decision Allows for Lower Wholesale Power Cost Adjustment

In early 2004, a decision by the Regulatory Commission of Alaska (RCA) allowed Homer Electric to decrease the wholesale power cost adjustment (WPCA) rate that is a component of the monthly bill received by members. The RCA directed Homer Electric's primary power supplier, Chugach Electric, to lower the rate it charges its wholesale power customers. The RCA also required Chugach Electric to issue a refund to Homer Electric and its other wholesale power customers to compensate for the excessive rate that had been in place.

Members Approve Raising Liability Limit

Homer Electric members overwhelmingly passed three ballot propositions at a Special Meeting of the Membership in December.

Proposition No. 1 asked HEA members to increase the borrowing limit of the cooperative from \$150 million to \$450 million. The HEA board unanimously supported raising the limit and urged members to vote in favor of the amendment to the Articles of Incorporation. The final vote tally indicated strong support for the amendment, with Proposition No. 1 garnering 3,346 'yes' votes (78%) to just 929 'no' votes (22%). Increasing the borrowing limit provides Homer Electric the financial flexibility to move forward with anticipated projects over the next ten to 20 years without burdening today's members with all the costs.

Proposition No. 2 was a bylaw amendment that calls for HEA directors to be elected by the members in their respective district rather than at-large. This amendment passed by a wide margin, with 3,691 'yes' votes (86%) and just 579 'no' votes (13.5%).

While the HEA Board did not take a stand on this proposition, it was clear from the results that the membership strongly supported the change.

Proposition No. 3 was a bylaw change that institutes term limits for Homer Electric directors. The term limits, which are not retroactive, limit directors' service to three consecutive, three-year terms. Like the other ballot propositions, this amendment also passed by a wide margin. The final vote was 3,341 'yes' votes (77.6%) to 963 'no' votes (22.3%).



New Generators Will Improve Power Reliability in Kachemak Bay Communities

Homer Electric replaced aging diesel generators in Seldovia which date back to the 1950's. The vintage generators provided emergency back up power when the central power station was interrupted. The replacement generators are online and operations have been running smoothly.



In addition, the villages of Port Graham and Nanwalek will benefit from a new standby generator that was installed in Port Graham last year. The diesel generator, housed in the Port Graham cannery generation building, is capable of providing electricity to Port Graham and its neighboring village, Nanwalek. In the past, the two villages received emergency power from the standby generator in Seldovia. However, if there was a problem on the

line between Seldovia and Port Graham, the villages were left in the dark until a crew could access the remote area to make repairs. Often, due to storms and rough weather, it would take several hours, even days, for the weather to clear enough to send a crew to the area.

Once the generator is automatically activated, it can be remotely put on line by a system operator at Homer Electric's operations center. The combination of automation and manual oversight allows for a prompt response, while ensuring that the switch to generation is done safely.

The Seldovia and Port Graham generator projects are a component of the Kachemak Bay Regional Power Project which is funded through state and federal grants. The Regional Power Project also included the replacement of the underwater cable between the Homer Spit and McKeon Flats (completed in 2001).

Spruce Bark Beetle Clearing Efforts

The clearing of Spruce Bark Beetle-killed trees on the peninsula remains a high priority for Homer Electric. This aggressive program, started in 1997, focuses on clearing beetle killed trees that are creating a hazard to electric service in the cooperative territory. While beetle-killed trees are prevalent throughout the HEA service area, the most significant problem is located on the south side of Kachemak Bay. The dead trees continue to come into contact with power lines on a regular basis, causing damage to electric facilities and creating costly power outages for Homer Electric members in Halibut Cove, Seldovia, Port Graham and Nanwalek.



In the summer and fall of 2004, Homer Electric was able to successfully clear danger trees along a por-

tion of the power line right-of-way on the south side of Kachemak Bay. Using a federal appropriation, along with matching funds from HEA, the clearing project focused on the area between McKeon Flats and Sadie Cove, taking in approximately 28,000 feet of electric line. The clearing work has significantly reduced outages in that area and additional clearing is required. Homer Electric will continue to work across the Bay to remove beetle-killed trees between Tutka Bay and Jakalof Bay.



Automated Meter Reading Pilot Study

For many years, Homer Electric has explored the use of an Automated Meter Reading (AMR) system. In late 2004, HEA launched an AMR pilot study that utilizes a sophisticated system

of using HEA power lines to transmit meter readings directly from a residential electric meter to HEA's operations center. The benefits of an AMR system for Homer Electric members would include high quality billing reads, reduced estimated meter readings and billings, and provide timely, accurate electric usage from the location. This system will also provide enhanced outage management tools and decrease the need to physically read the meter.

Homer Electric has installed 200 test meters in the Kenai/Soldotna area. This trial system will be evaluated throughout the first half of 2005 to determine if the AMR product meets Homer Electric's needs.

As early as February 2005, the system has provided meter reads in less than three seconds and the reads

are 100% accurate. The next phase of the study is to evaluate the billing interface program. The success of this study thus far is largely due to our many dedicated, capable employees.

Pebble Gold/Copper Project

One of the most significant projects discussed on the Kenai Peninsula over the past year has been the proposed Pebble Gold/Copper Project on the west side of the Cook Inlet. If the Pebble Project develops as anticipated, it has the potential of providing a significant economic boost to the local communities.

Homer Electric and Northern Dynasty Minerals Ltd. have agreed to jointly assess the technical, economic and environmental feasibility of a phased development approach to ensure the timely delivery of electrical power to construct and operate a gold/copper mine at Pebble. Potential benefits include stabilizing the long term cost of wholesale power, improving system reliability, and diversifying HEA's source of energy.

HEA will continue to monitor this project to determine what benefits it may bring to the cooperative and its members.

Wind Power Generation

Homer Electric is exploring the potential of wind power generation. Homer Electric, working in conjunction with Chugach Electric, Municipal Light & Power and Golden Valley Electric, will investigate the economic viability of a wind power project on Fire Island. The island is three miles offshore from Anchorage and its southern half is subject to regular winds from the Turnagain Arm.

As natural gas prices rise, a portion of the cost to fuel Chugach Electric's power plants is passed to its wholesale customers like Homer Electric. A wind generation project, if expanded to its full scope of 100 megawatts, would reduce Chugach's requirements for natural gas by 14%. The renewable fuel source of wind power offsets high capital costs to potentially provide an economical source of energy to the Railbelt utilities.

Homer Electric is excited to take part in this project that will benefit the entire Railbelt system.

Retirement & Employee Longevity Awards

Homer Electric Association recognizes the outstanding team of individuals who work diligently to ensure you have safe, reliable electric service on a daily basis. In 2004, HEA said goodbye to many of our fellow co-workers who have been with the Homer Electric family for decades. Join us in thanking these individuals who served their cooperative and have retired after many years of hard work:



Al Pyhla, Homer Foreman, receives a ring for his 20 year anniversary with HEA. Al will also retire in 2005.

- Ron Eichler, Fleet Superintendent in Kenai, retired after 30 years of experience with HEA.
- Lee Hankins, Homer Warehouseman, retired after 28 years.
- Bill Thompson, Superintendent in Kenai, retired after 26 years.
- Steve Cook, Working Foreman in Kenai, retired after 26 years.
- Mike Denison, Kenai's Engineering Tech II, retired after 25 years.
- Laura Felton, Kenai Member Service Representative, retired after 20 years.
- Bob Quinn, Homer's Superintendent, retired after three years.

Congratulations to several employees who celebrated their 20-year HEA employment anniversaries in 2004:

- Mike Anderson, Kenai Lineman
- Dave Bear, Land Management Officer in Kenai
- Sylvia Dale, Kenai's Engineering Tech II
- Laura Felton, Kenai Member Service Representative
- Al Pyhala, Homer Foreman
- Steve Seelye, Homer Foreman.

Celebrating their HEA 10-year anniversary:

- Jeanette Dick, Accounting Supervisor in Homer
- Duane Parlow, Manager of Administrative Services in Homer
- John Sherlock, Nikiski Power Plant Operator
- Richard Turner, Bradley Lake Hydro Operator Maintenance Electrician.

Treasurer's 2004 Annual Report



Homer Electric Association is committed to establishing electric rates that are competitive with those of other electric utilities in Alaska. As of January 1, 2004, we had the lowest residential rates in the Railbelt.

In 2004, the Superior Court rejected Chugach Electric's appeal of a rate increase resulting in a savings of \$900,000 per year. A rebate of \$1,700,000 was already received in 2003.

Homer Electric concluded the year 2004 with total consolidated revenues and non-operating income of \$53.8 million. That, combined with total consolidated costs of electric service of \$52.7 million resulted in a positive margin of \$1.1 million. The following is a financial summary for the year.

Retail Sales:

Homer Electric sold 498.8 million kilowatt-hours of electricity in 2004, an increase of 5.7 percent from 2003. The increase was fairly even across all classes of energy sales.

Revenues:

Revenue from energy sales was \$44.5 million, up from 2003, due largely to an increase in commercial and industrial sales although residential and small commercial sales were up slightly as well.

Key Ratio:

HEA's equity-to-total assets ratio (the accumulated ownership of the members in the assets of the utility) was 34.4 percent at year end, down 0.3 percent from 2003, but consistent with the Board's Equity goals. The equity-to-total assets ratio of Alaska Electric & Energy Cooperative's (AEEC), a single member cooperative which owns Homer Electric's generation and trans-

mission assets, was 23.3%, above the recommended debt covenant of 20%.

Debt Cap:

The Special Meeting of the Membership in December 2004 approved amendment of our debt cap to \$450 million. At December 31, 2004, our consolidated debt was \$146,608,198, which is consistent with most electric cooperatives the size of Homer Electric.

Wholesale Power Cost Adjustment:

This is the rate that reflects changes in the cost of purchased power. The wholesale power cost rate increased from \$.0180 per kWh to \$.02517 throughout the year. January 1, 2005, the rate dropped to \$(.01107) per kWh.

Capital Credits:

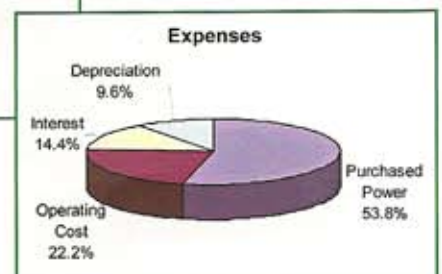
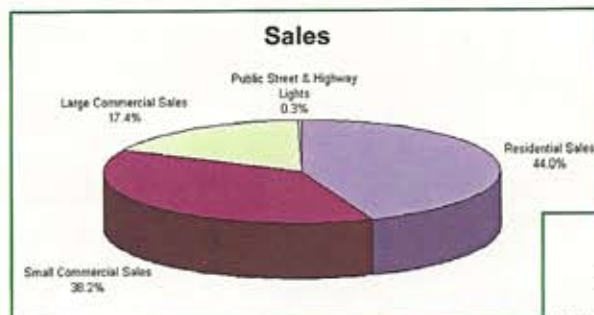
The 2004 budget approved by the board did not include funds for General Capital Credit retirements. The decision was made by the board as part of an overall effort to minimize rate increases.

System:

Services in place at year end totaled 28,350, a 2.2 percent increase from 2003. There were 772 new services connected and 154 services retired, resulting in 618 additional services for the year.

Homer Electric had a financially productive year while keeping costs and rates down, providing greater value to its members.

In conclusion, Homer Electric had a financially productive year while keeping costs and rates down, providing greater value to its members.



Homer Electric Association, Inc. Consolidated Balance Sheets

December 31, 2004 and 2003

ASSETS	2004	2003	EQUITIES & LIABILITIES	2004	2003
UTILITY PLANT (at cost):			EQUITIES AND MARGINS:		
Electric plant	\$234,028,418	\$223,189,355	Memberships	\$98,745	\$97,130
Electric plant held for future use	3,391,408	2,529,174	Patronage capital	47,549,719	47,003,200
Construction work in progress	<u>9,442,968</u>	<u>10,526,045</u>	Other equities - donated capital	1,240,076	1,239,983
Total Utility Plant	246,862,794	236,314,574	Total equities and margins	49,588,540	49,040,313
Less accumulated depreciation & amort. ..	<u>(87,095,709)</u>	<u>(80,156,443)</u>			
Net utility plant	159,767,085	156,158,131			
OTHER ASSETS AND INVESTMENTS:			LONG-TERM DEBT:		
Investment in assoc. organizations	15,815,759	15,513,183	NRUCFC mortgage notes	<u>131,709,296</u>	<u>125,780,234</u>
Other investment	1,950,065	247,120			
Notes receivable	1,561,869	1,504,150			
Non-utility property, net of accum. depreciation of \$84,643 in 2004 and \$48,102 in 2003	<u>698,255</u>	<u>702,191</u>			
Total other assets & investments ..	20,025,948	17,966,644			
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash & cash equivalents	3,509,060	5,195,703	Current portion of long-term debt	4,570,862	4,522,891
Accounts receivable, less allowance for doubtful accounts of \$192,962 in 2004 and \$134,235 in 2003	4,101,060	4,160,462	Accounts payable	2,771,173	2,456,334
Unbilled revenue	2,800,000	2,300,000	Wholesale power cost adjustment	571,824	2,079,278
Materials, fuel and supplies	2,635,977	2,326,288	Consumer deposits	650,059	597,480
Notes receivable, current portion	727,915	803,411	Accrued payroll and benefits	1,134,130	1,365,984
Other current and accrued assets	<u>239,155</u>	<u>243,449</u>	Accrued taxes and other current liabilities	<u>839,652</u>	<u>773,258</u>
Total current assets	14,013,167	15,029,313	Total current liabilities	10,537,700	11,795,225
DEFERRED CHARGES	2,390,538	3,710,132	DEFERRED CREDITS:	4,361,202	6,248,448
	<u>\$196,196,738</u>	<u>\$192,864,220</u>		<u>\$196,196,738</u>	<u>\$192,864,220</u>

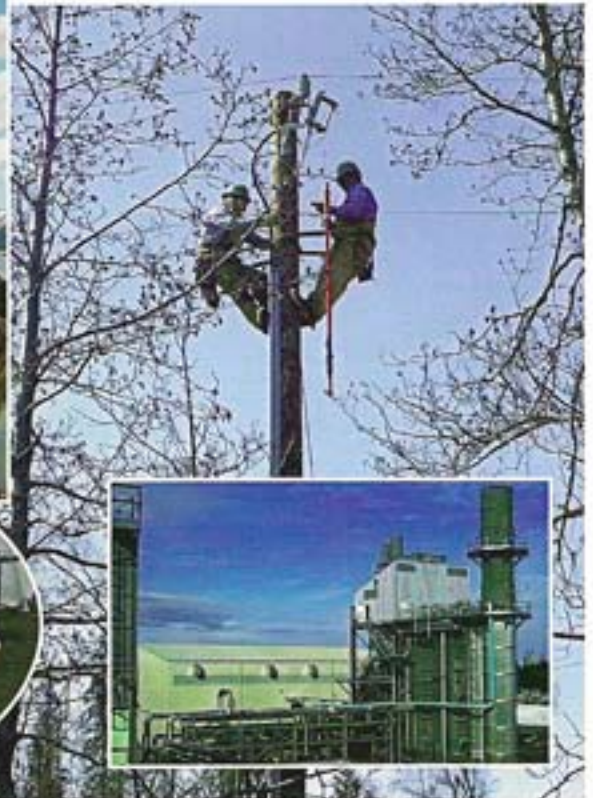
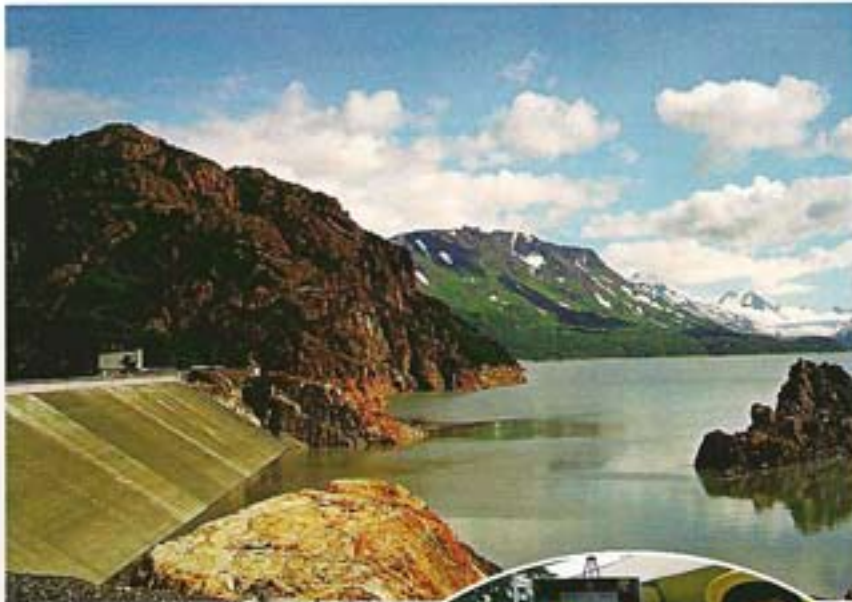
Consolidated Statements of Operations & Patronage Capital

	2004	2003
Operating Revenues	\$52,797,409	\$47,179,480
Operating Expenses:		
Cost of power	28,341,755	23,557,587
Transmission expense	189,301	221,988
Distribution - operations	867,980	1,277,321
Distribution - maintenance	2,603,794	2,924,054
Production - maintenance	190,668	213,967
Consumer accounts	2,305,113	2,110,302
Customer service & information	354,522	327,761
Sales expense	143,900	193,215
Administrative and general	4,935,813	5,299,014
Depreciation and amortization	7,591,510	7,267,020
Taxes	246,428	238,434
Miscellaneous	<u>97,143</u>	<u>118,294</u>
Total operating expenses	47,867,927	43,749,657
Operating margins before fixed charges	4,929,482	3,429,823
Fixed charges:		
Interest on debt	(4,795,051)	(3,983,733)
Allowance for borrowed funds used during construction	233,429	159,987
Total fixed charges	(4,561,622)	(3,823,746)
Operating margins (loss) after fixed charges	367,860	(393,923)
Patronage capital allocation	481,816	831,261
Net operating margins (loss)	849,676	437,338
Non-operating margins:		
Interest income	261,767	389,348
Other income (expense)	(23,396)	639,606
Total non-operating margins	238,371	1,028,954
Net margins (loss)	1,088,047	1,466,292
Patronage capital - beginning of year	47,003,200	47,429,721
Less retirement of patronage capital credits	(541,528)	(1,892,813)
Patronage capital - end of year	\$47,549,719	\$47,003,200

HEA at a Glance

POWER

Nikiski Cogeneration Plant	39.0 MW
Seldovia Power Plant	2.5 MW
Bradley Lake Hydroelectric	14.0 MW
Total Generating Capacity	55.5 MW



FACTS

- 19,758 member-owners
- 28,370 meter locations
- 2,536 idle services
(excludes seasonal)
- 9 members per mile of line
- 12.9 meters per mile of line
- 3,166 square-mile service area



Homer Electric Association, Inc. Board of Directors

- David R. Carey, President
- Hugh Chumley, Vice President
- Mike Nugent, Secretary/Treasurer
- Debbie Debnam, Deputy Secretary
- Ruth Fitzpatrick, Director
- Roseleen (Snooks) Moore, Director
- Bruce Passe, Director
- J. Michael Pate, Director
- John Standefer, Director