
Homer Electric
Association, Inc.
A Touchstone Energy® Cooperative
NEWGENERATION
2012 Annual Report

MESSAGE
from the President & General Manager

Greetings from the Board of Directors and staff at Homer Electric Association (HEA).

If it feels to you like 2012 was a busy year at Homer Electric Association, you are right! The cooperative has been focused on the completion of several major projects that are key to the successful launch of Independent Light, HEA's program to generate its own power beginning on January 1, 2014.

Brad Janorschke
General Manager

We are on the brink of a new era at HEA, a "New Generation", where we will be operating power plants, dispatching power, securing gas contracts, building transmission lines, distributing electricity, and meeting the electric utility needs of our nearly 23,000 members.

It's a formidable task, but we are completely confident we will be successful and the end result will be a huge benefit for the HEA membership.

During the past year, activities at the two major components of Independent Light have provided a spark to the local economy. Construction crews were busy throughout 2012 at the Nikiski Combined Cycle Project and the Soldotna Combustion Turbine Project sites. Approximately 30 Kenai Peninsula contractors and subcontractors were employed on these projects, with a total of 470,000 man-hours committed to the construction work.

Debbie Denham
President

Once completed, the new generation plants will provide nearly 20 new full-time jobs for Kenai Peninsula residents. In the past, these jobs were located in Anchorage.

When we broke ground at the Nikiski site in April 2011, we spoke about the goal of creating jobs here on the Kenai Peninsula. It is good to see that the goal has become a reality and our vision of producing power on the Kenai Peninsula is taking shape.

The following pages of the 2012 Annual Report provide additional details on the progress made during the year, as well as the financial status of the cooperative. We hope you will take the time to read through this and continue to be an active and involved member of the cooperative.

In closing, we would like to pay our respects to the memory of HEA Board member Mike Wiley. Mike passed away on December 7th, 2012, and left a void in the Kenai Peninsula community that will be impossible to fill. Mike was affiliated with several community groups, including the Kasilof Regional Historical Association, Central Peninsula Garden Club, and the Kenai Peninsula Fishermen's Association. He also served in elective office for Homer Electric Association, the Borough Assembly and the Kenai Peninsula School Board.

Mike Wiley

On HEA's Board, Mike was a strong voice for the HEA members and always put the interests of the members first. He was also an advocate of renewable energy and was outspoken in his support of the proposed Grant Lake hydro project near his former home town of Seward.

As Mike's family wrote in his obituary, he was generous with his time and was an extraordinarily kind person to all he met.

He will be greatly missed by all of us at Homer Electric.

NEWGENERATION

Homer Electric Association (HEA) is entering a new era and has been setting the foundation for positive changes for your electric cooperative. By 2014, the Independent Light Program (ILP) will come to fruition. Independent Light is Homer Electric's plan to generate and provide its own power for its members and become the first full service electric utility located on the Kenai Peninsula. The Independent Light Program has been the focus over the past few years and each step of the way has been a strategic stride in reaching the goal.

2012 YEAR IN REVIEW

New Generation

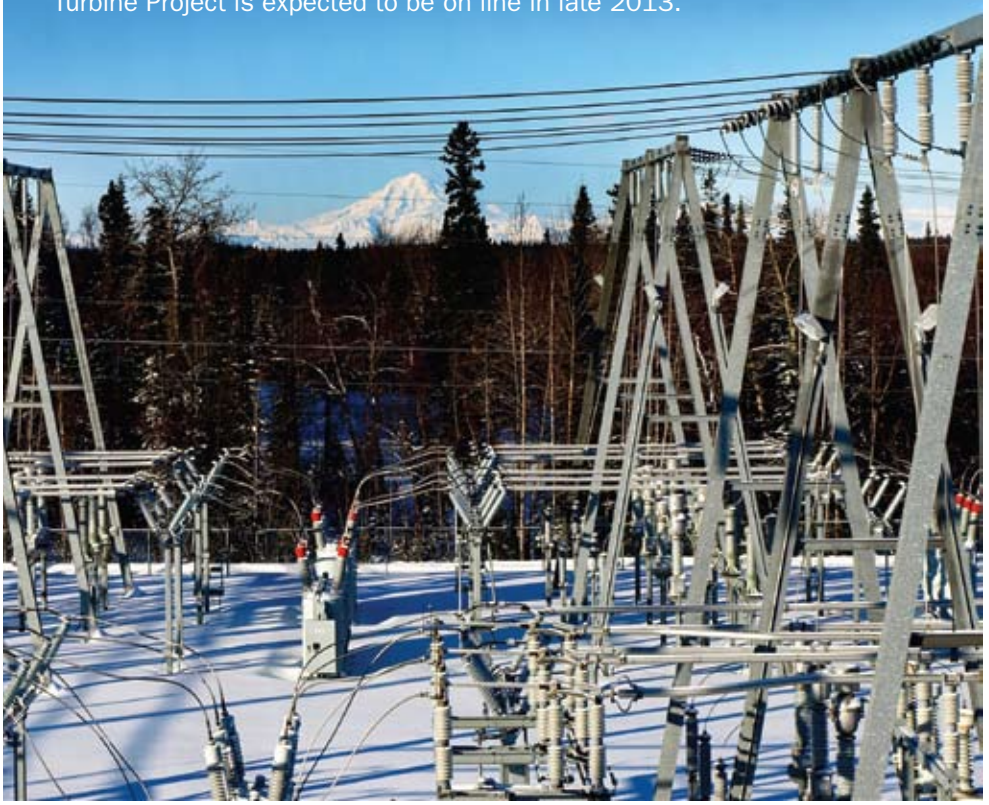
NIKISKI
Combined Cycle Project

In 2012, Homer Electric continued its progress with Independent Light, which is HEA's plan for producing its own power beginning January 1, 2014.

The cornerstone of ILP is the Nikiski Combined Cycle Project and the primary component of the project is a steam turbine. The new turbine will be powered by steam produced from exhaust heat coming off the existing natural gas turbine. Upon completion of the project, the capacity of the existing Nikiski Generation Plant will nearly double, from 40 megawatts (MW) to as much as 80 MW.

SOLDOTNA Combustion Turbine Project

A second component of the Independent Light Program is the installation of a combustion turbine at HEA's property on the Sterling Highway in Soldotna. The 48 MW LM 6000 turbine will be used as a backup source of power for HEA. Construction is underway and the Soldotna Combustion Turbine Project is expected to be on line in late 2013.



BERNICE LAKE Combustion Turbine Plant

A third component of ILP is the Bernice Lake Combustion Turbine Plant which was purchased by HEA in 2011 from Chugach Electric. The addition of the Bernice Lake Power Plant to Homer Electric's generation portfolio eliminated the need for a second turbine at Soldotna and will save HEA members more than $15 million dollars.

Given our current power supply needs, the Nikiski plant will be the primary source of power for Homer Electric starting in 2014.

Peaking and reserve capacity will be available from the Soldotna and Bernice Lake Plants. In addition, HEA also receives a share (11 MW) of the power produced at the state-owned Bradley Lake hydroelectric facility at the head of Kachemak Bay.

PREVENTIVE MAINTENANCE

Keeping The Lights On

CABLE INJECTION

HEA has approximately 166 miles of underground cable in its distribution system that was installed prior to 1990. Since 2007, HEA has been at the forefront of an alternative method to treat aging underground conductor called Cable Injection. This process costs significantly less than replacing the cable and can extend the life of existing conductor by as much as 40 years. This program has had a positive impact on the reliability of the underground system.

In 2012, 23,199 feet of underground aged conductor was injected and 2,922 feet was replaced bringing the total injection footage to approximately 126,809 feet (24 miles) since 2008. In addition, four miles of underground cable has been replaced during that time. Over the years, this technique has fostered a successful maintenance program while providing a great savings opportunity.

BEAR DAMAGED POLES

Homer Electric's service territory is vast and wild. A reminder of the effects of our environment and animal neighbors is evident in the damage that our distribution poles succumb to each year.

HEA replaced eight distribution poles between Seldovia and Port Graham as a result of bear damages. In addition, deterrents were added to protect the poles from future damage.

MEMBER SERVICES

Service with a Smile

MEMBER COMMUNICATION

Homer Electric strives to provide members with information at their fingertips and utilize new ways to communicate with members. Homer Electric introduced FACEBOOK to deliver real-time power outage notifications, and an electronic news brief, Watts New, to inform members of upcoming events and programs. Wise Watts, an HEA blog, was launched in 2012 to provide the latest energy conservation tips to help members learn more about how to control their electric costs.

NEW RATE STRUCTURE

The implementation of a new electric rate structure kept the member services team particularly busy in early 2012 as they educated members on the new rate design. As of January 1, 2012, members began seeing a new line item on their monthly energy bill, originally called the Minimum Energy Charge, which was later renamed the System Delivery Charge. The Wholesale Power Cost Adjustment fee was also renamed the Cost of Power Adjustment.

The new rate structure moves Homer Electric closer to ensuring that all costs to serve a location, whether or not energy is sold, are recovered equitably throughout the system.

SAFETY First

Many Homer Electric employees fulfill dangerous tasks each day to provide a luxury that we have all become accustomed to and expect – power at the flip of a switch. We take pride in our safety program that includes internal training, monthly safety meetings, and an active safety committee. Homer Electric is striving to become the safest utility in Alaska so we can protect not only our members, but the people we work closely with.

Perhaps what makes us the most proud is that 2012 was our safest year on record. Safety is our highest priority. If we don't create a safe work environment for our employees, none of our other successes matter.

NEIGHBORS Helping Neighbors

Homer Electric employees are a vital part of our community – in your church, as your child's coach, performing in our theaters, as your hockey teammate, on service boards, volunteering in schools, and contributing in various community civic groups. We are grateful for our team of professional and compassionate employees. Thank you for making a difference – you are an asset inside and outside of the office.

EMPLOYMENT ANNIVERSARIES

Brad Hibberd	20 years	Brian Bennett	10 years	Kathy McDonough	10 years
Susan Oliver	20 years	Wendell Dutcher	10 years	Jim Cross	10 years
Connie Orth	20 years	Diana Imlay	10 years	Brian Burk	10 years

2012 TREASURER'S Annual Report

Dick Waisenen
Treasurer

Homer Electric Association is committed to establishing electric rates that allow us to provide reliable electricity at fair and reasonable prices to our members.

Homer Electric concluded the year 2012 with total consolidated revenues and non-operating income of $91 million. That, combined with total consolidated costs of electric service of $86 million, resulted in a positive margin of $5 million. The following is a financial summary for the year.

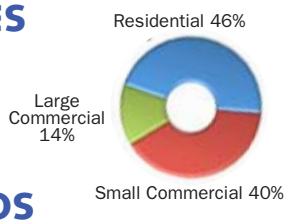
RETAIL SALES

2012	489.67 Million kWh	
2011	474.67 Million kWh	
2010	469.92 Million kWh	

Homer Electric sold 490 million kilowatt-hours of electricity in 2012, an increase of 3% from 2011. The increase in sales was primarily due to a 7% increase in the large commercial sales class.

REVENUES

Revenue generated from energy sales totaled $80 million. This was an increase of 5% over 2011 and was due to increased energy sales across all classes.



KEY RATIOS

The equity-to-total-assets ratio measures the percentage of total assets owned by the members and is used as an indicator of financial health. HEA's ratio was 34% at year end, the same as 2011. The same ratio for Alaska Electric & Energy Cooperative (AEEC), HEA's subsidiary which owns our generation and transmission assets, was 12%. Both ratios are in compliance with our debt covenant requirements.

COST OF POWER ADJUSTMENT (COPA)

This is the energy rate component that reflects changes in the cost of purchased power due primarily to the fluctuating cost of fuel. The cost of power adjustment decreased from 5.103 cents per kWh on January 1, 2012, to 4.884 cents per kWh on December 31, 2012.

RATE PER RESIDENTIAL KWH *IN DECEMBER

2012	17.64 Cents/kWh	
2011	19.05 Cents/kWh	
2010	15.34 Cents/kWh	

Base Rate COPA

EXPENSES

In 2012, total expenses were $86 million up $5 million or 7% from 2011. Purchased power costs increased $1.4 million and comprised 52% of the total costs. Operating costs, depreciation expense, and interest expense increased 11% from 2011 expenses. The increase in costs was due primarily to those associated with the acquisition of the Bernice Lake Combustion Turbines as well as increases in other generation and transmission assets.

WHERE YOUR DOLLAR WENT

52¢ Purchased Power

12¢ Maintenance & Operation

11¢ Interest & Taxes

11¢ Depreciation & Amortization

9¢ Administrative & General

5¢ Consumer Accounts Expense

CAPITAL CREDITS

In 2012, the Board of Directors approved the retirement of approximately $1.7 million in capital credits to members. Specifically, Estate Capital Credits were distributed in the amount of $182,765 and general capital credits of $1.5 million were distributed to members of HEA in 1985 and 1986, as well as those who were members in 2011.

Capital credits represent Homer Electric members' share of equity in the utility and are one of the benefits of being a member of an electric cooperative. Capital credits are based on margins, which are the difference between total expenses and total revenues of the cooperative. Each year, HEA allocates margins to its members in proportion to the amount they paid for electric service.

SYSTEM

There were 32,731 services in place at year end. The net increase of 530 services in 2012 was a 2% increase over 2011 services.

FINANCIAL GOALS

In conclusion, Homer Electric met its financial goals of a positive margin and a stable equity–to-assets ratio in 2012. HEA's careful financial management and resulting strong financial performance allows HEA to continue to meet the energy needs of our members through innovative energy solutions, while ensuring as fair and reasonable rates as possible.

HOMER ELECTRIC ASSOCIATION, INC. AND SUBSIDIARY
Consolidated Balance Sheets
December 31, 2012 and 2011

Assets	2012	2011
Utility plant, at cost:		
Electric plant in service	$ 334,938,330	310,788,824
Electric plant held for future use	21,671,980	21,671,980
Construction work in progress	143,489,415	80,422,836
Total utility plant, at cost	500,099,725	412,883,640
Less accumulated depreciation and amortization	(144,055,281)	(128,833,061)
Net utility plant	356,044,444	284,050,579
Other assets and investments:		
Investments in associated organizations	19,078,154	18,524,452
Other investments	-	199,180
Notes receivable, net of current portion	812,384	669,395
Non-utility property, net of accumulated depreciation of $370,851 ($335,155 in 2011)	406,118	494,320
Total other assets and investments	20,296,656	19,887,347
Current assets:		
Cash and cash equivalents	6,301,607	7,722,984
Accounts receivable, less allowance for doubtful accounts of $86,072 ($71,271 in 2011)	8,285,455	7,817,426
Unbilled revenue	3,935,414	3,744,959
Materials, fuel and supplies inventory	5,314,797	4,835,204
Notes receivable, current portion	603,981	586,302
Other current and accrued assets	370,023	357,124
Total current assets	24,811,277	25,063,999
Deferred charges	9,422,723	9,903,738
Total assets	$ 410,575,100	338,905,663

Equities and Liabilities	2012	2011
Equities and margins:		
Memberships	$ 61,335	64,200
Patronage capital	71,785,269	68,482,616
Other equities - donated capital	2,615,806	2,377,672
Total equities and margins	74,462,410	70,924,488
Long-term debt - mortgage notes payable	300,484,642	232,059,285
Current liabilities:		
Current portion of long-term debt	8,524,508	7,743,828
Accounts payable	15,453,189	10,550,263
Consumer deposits	1,068,301	1,065,828
Accrued payroll and benefits	2,441,411	1,953,405
Accrued taxes and other current liabilities	1,140,325	1,140,199
Total current liabilities	28,627,734	22,453,523
Deferred credits	7,000,314	13,468,367
Total equities and liabilities	$ 410,575,100	338,905,663

Consolidated Statements of Operations and Patronage Capital
Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenues	$ 89,557,336	84,291,997
Operating expenses:		
Purchased power costs	45,172,980	43,819,516
Transmission expense	1,844,697	1,254,723
Distribution operations	2,065,519	1,638,006
Distribution maintenance	4,981,703	4,997,653
Production maintenance	1,677,553	1,233,754
Consumer accounts	3,302,878	2,880,362
Customer service and information	512,054	504,011
Sales expense	115,361	119,543
Administrative and general	7,680,709	6,775,692
Depreciation and amortization	9,109,216	8,166,040
Taxes	242,975	236,880
Miscellaneous	437,824	188,002
Total operating expenses	77,143,469	71,814,182
Operating margins before fixed charges	12,413,867	12,477,815
Fixed charges:		
Interest on debt, net of capitalized interest	9,150,434	9,038,567
Allowance for funds used during construction	(481,127)	(287,353)
Net fixed charges	8,669,307	8,751,214
Operating margins after fixed charges	3,744,560	3,726,601
Patronage capital allocation	1,067,827	1,176,175
Net operating margins	4,812,387	4,902,776
Nonoperating margins:		
Interest income	216,630	228,340
Other income	(43,757)	29,126
Total nonoperating margins	172,873	257,466
Net margins	4,985,260	5,160,242
Patronage capital at beginning of year	68,482,616	63,404,829
Less retirement of patronage capital credits	(1,682,607)	(82,455)
Patronage capital at end of year	$ 71,785,269	68,482,616