

CALENERGY COMPANY, INC.  
1997 ANNUAL REPORT



A FORCE FOR THE FUTURE



**Our Strategy**

COMMITMENT TO  
OUR CONSTITUENTS

EXCELLENCE IN  
CORE BUSINESS OPERATIONS

DISCIPLINED ACQUISITIONS AND  
NEW PROJECT DEVELOPMENTS

PRUDENT FINANCIAL AND  
RISK MANAGEMENT

Our well-planned **strategy for growth** is the basis for our success and has enabled our Company to expand and prosper. [ ¶ ] Our **commitment to our constituents** is unwavering. As our Company has grown, we have continued our dedication to environmental stewardship and to providing increased opportunities and an enhanced quality of life to our customers, shareholders, employees, and those of the communities we serve – people whose successes parallel our own. [ ¶ ] Our commitment to **excellence in core business operations** has further advanced our success by optimizing our

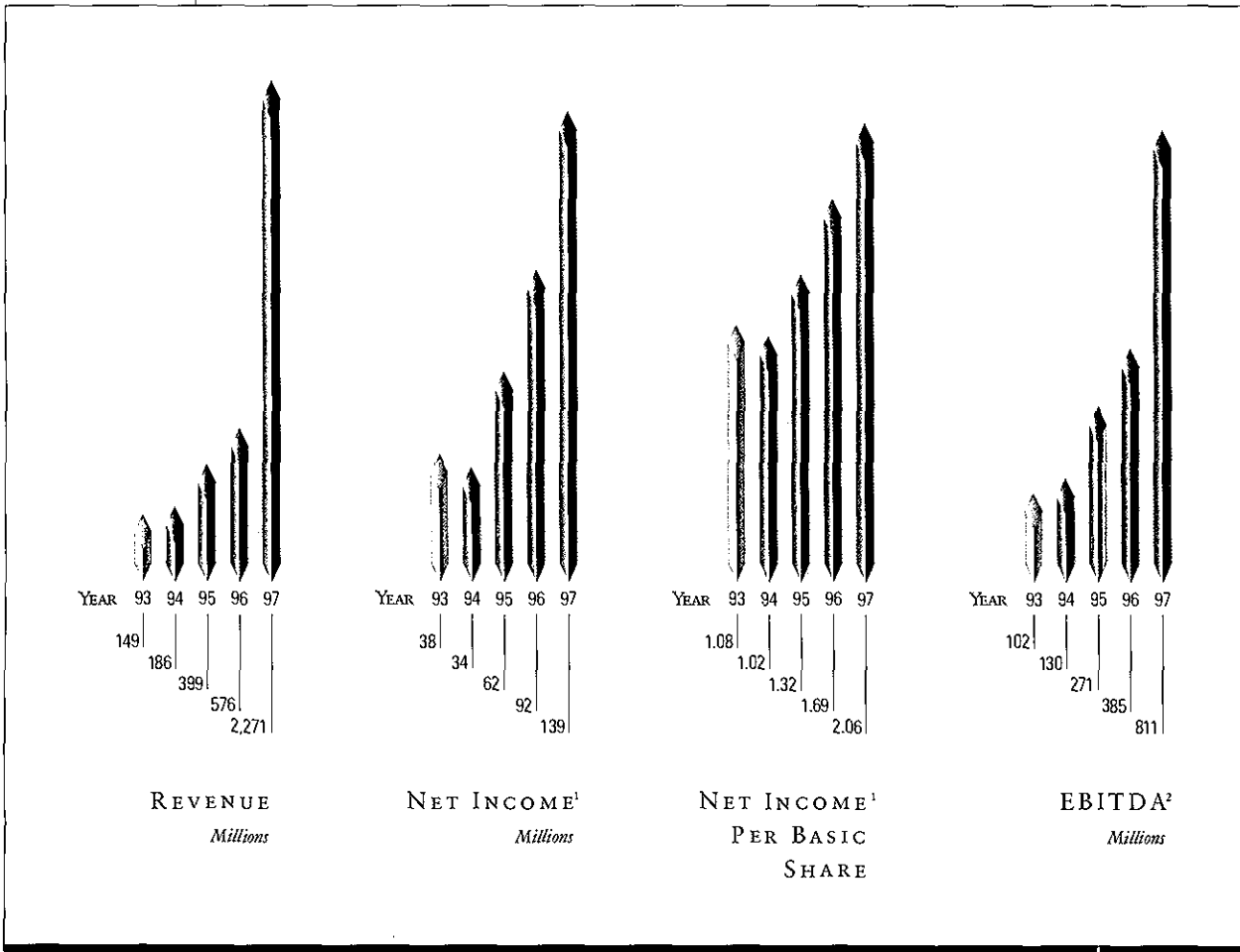
## CalEnergy's Strategy for Growth

use of technology, ensuring the development of innovative customer services, and maintaining our focus on operational excellence and safety in every area of our Company. [ ¶ ] Through **disciplined acquisitions and new project developments** we have increased our skill base and broadened our position as a leading global energy services company. [ ¶ ] And finally, through **prudent financial and risk management**, our Company has achieved impressive growth and economic performance.

# Financial Highlights

(Amounts in millions of U.S. dollars except per share amounts.)

	1995	1996	1997
Revenue	\$ 399	\$ 576	\$ 2,271
Net Income <sup>1</sup>	\$ 62	\$ 92	\$ 139
Net Income Per Basic Share <sup>1</sup>	\$ 1.32	\$ 1.69	\$ 2.06
EBITDA <sup>2</sup>	\$ 271	\$ 385	\$ 811



<sup>1</sup> Before extraordinary item, cumulative effect of a change in accounting principle, and non-recurring item.  
<sup>2</sup> Earnings before interest, taxes, depreciation, amortization, and non-recurring item.

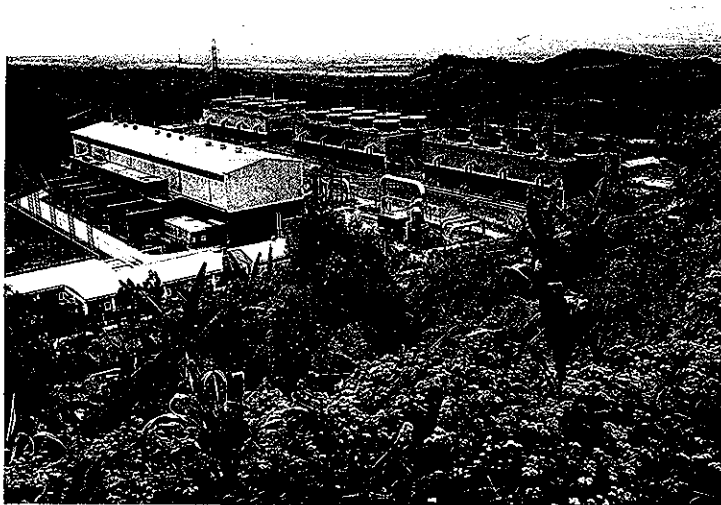
CalEnergy Company, Inc. stock is publicly traded on the New York Stock Exchange, the Pacific Stock Exchange, and the London Stock Exchange under the trading symbol "CE."

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# Company Overview

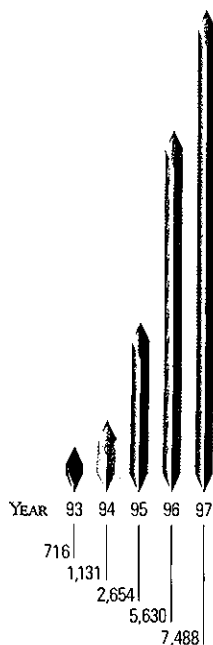
## Who We Are



*CalEnergy's Malitbog geothermal power project supplies much-needed electricity to the island of Leyte, Republic of the Philippines.*

CalEnergy Company, Inc. ("CalEnergy" or "the Company") was founded in 1971 as a consultant to geothermal power production facilities in North America. Since that time, many events have occurred in the United States and elsewhere that have provided important opportunities for our Company.

As you read through our 1997 Annual Report, we hope that it will become apparent that CalEnergy is well prepared to benefit from the energy industry deregulation and privatization occurring worldwide. We have long been committed to our mission *to become a leading global provider of a full range of energy services*, a goal we have continued to pursue in 1997.



**HISTORICAL  
GROWTH IN  
TOTAL ASSETS**

*Amounts in Millions of U.S. Dollars*

### Our Performance in 1997

CalEnergy has successfully expanded its role from that of an independent power producer to a global energy company that now supplies and distributes electricity and gas to nearly 1.8 million retail customers in the United Kingdom, and manages and owns interest in over 5,000 net megawatts ("MW") of power generation facilities in operation, construction and development worldwide.

Financial results and customer growth at Northern Electric plc, our electricity distribution and electricity and gas supply company in the U.K., have significantly exceeded our expectations throughout the past year. Through constant improvement of productivity and cost reductions, our geothermal and natural gas generation facilities in the U.S. have continued to show excellent operating performance and have remained a predictable and significant source of cash flow for the Company. Also in 1997, we completed construction and began receiving revenue on two geothermal power generation projects in the Philippines.

CalEnergy achieved outstanding financial growth during 1997:

- ▶ Assets increased to nearly \$7.5 billion from \$5.6 billion in 1996—  
*a 33 percent increase*
- ▶ Revenues surged to nearly \$2.3 billion from \$576 million in 1996—  
*a 294 percent increase*
- ▶ Net income<sup>1</sup> increased to \$139 million from \$92 million in 1996—  
*a 51 percent increase*
- ▶ Net income per basic share<sup>1</sup> increased to \$2.06 from \$1.69 in 1996—  
*a 22 percent increase*
- ▶ EBITDA<sup>2</sup> increased to \$811 million from \$385 million—  
*a 111 percent increase*

<sup>1</sup> Before extraordinary item, cumulative effect of a change in accounting principle, and non-recurring item.

<sup>2</sup> Earnings before interest, taxes, depreciation, amortization, and non-recurring item.

### **Our Vision: A Force for the Future**

CalEnergy has experienced remarkable growth since 1991 when, in response to the evolving world energy markets, we developed a strategy to:

- ▶ *employ additional energy sources to fuel our generation assets*
- ▶ *broaden our base of energy services by including distribution and supply*
- ▶ *expand our target markets to encompass select opportunities worldwide*

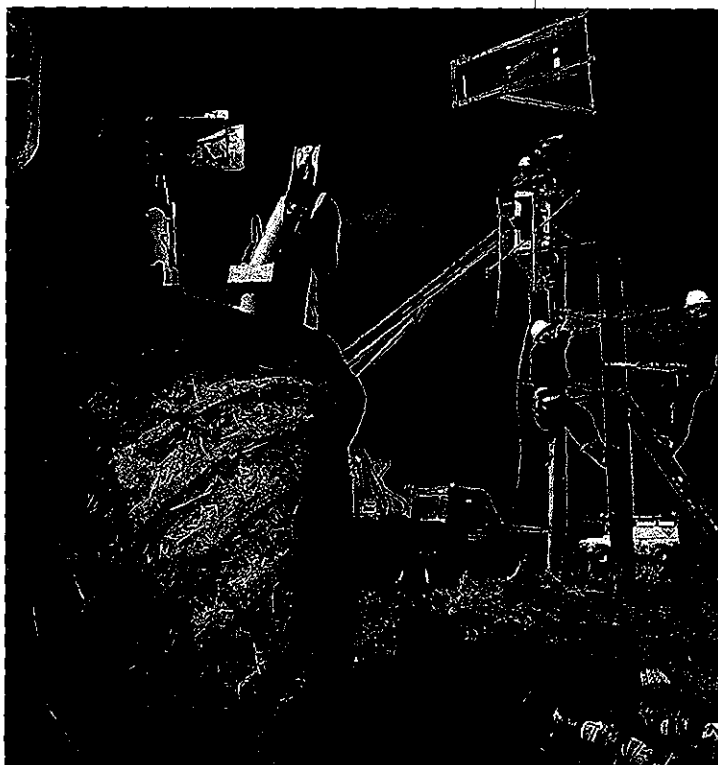
By focusing on our core competencies of resource-based development and strategic acquisitions, we have achieved enviable growth and financial performance and have established the experience base, asset base and financial base for future growth. Our strategy is based upon:

- ▶ *Commitment to Our Constituents*
- ▶ *Excellence in Core Business Operations*
- ▶ *Disciplined Acquisitions and New Project Developments*
- ▶ *Prudent Financial and Risk Management*

Today, more than any other time in its history, the global energy industry is preparing for change. Deregulation and privatization are occurring rapidly around the world. Economic uncertainties, as evidenced by Asia, underscore the importance of foresight and prudent restraint. CalEnergy has demonstrated the knowledge and core competencies to compete successfully in this changing industry, and has taken measures to protect our investments against possible unexpected economic and political adversity in the countries where we do business.

We understand that our success is tied directly to our performance and flexibility—past, present, and future—and to our ability to identify and take prompt, decisive action to seize opportunities in the face of industry change. We are excited about the potential to broaden our supply business in the U.K. and elsewhere, and believe that new and expanding opportunities exist to introduce Northern Electric's proven and proprietary information technology and customer billing services to the U.S. and other deregulating utility markets. Additionally, gas and geothermal exploration and development activities will provide the Company with many more exciting opportunities worldwide.

In this regard, we are convinced that we have properly structured our organization in preparation for both the challenges and the opportunities that will arise as we approach the new millennium and continue our journey as a force for the future.



*As part of a major ongoing investment program, Northern Electric continues to refurbish its electricity distribution assets.*

## Chairman's Message

### *Committed to Our Strategy*

For the majority of our business, 1997 was a year of great accomplishments. It was clearly also a year of frustration in our Indonesian activities. Revenues exceeded \$2.25 billion. Net income, excluding non-recurring and extraordinary charges exceeded \$138 million. Earnings before interest, taxes, depreciation, amortization, and non-recurring charges ("EBITDA") exceeded \$800 million. Of particular note, since 1990, revenue, net income and EBITDA have had cumulative annual growth rates of 57 percent, 42 percent, and 45 percent, respectively, excluding non-recurring and extraordinary charges. By any reasonable measure, these are very respectable results for a growth company in our industry.



*David L. Sokol*  
Chairman of the Board and Chief Executive Officer

The full integration of Northern Electric into CalEnergy, the completion of the Mahanagdong and Malitbog geothermal power generation facilities in the Philippines, the award and initiation of gas-based power developments in Poland and Australia, and the continued strength of the operations of our U.S. generating facilities marked an eventful year. Additionally, the purchase of Peter Kiewit Sons', Inc. 30 percent holdings in A-rated Northern Electric, their investments in our Asian projects, and their 20.2 million CalEnergy shares was an important step both toward broadening our position as a leading global energy services company and providing a source of annual earnings growth for the future.

In addition, as a result of concrete achievements, we further refined our strategy to significantly expand our presence in the deregulated energy and gas markets of the United Kingdom and the United States. By year-end 1997, through the utilization of Northern Electric's proprietary information technology and innovative marketing initiatives, Northern added nearly 300,000 new gas customers to their 1996 base of 1.45 million electricity customers. This equates to a 20 percent increase of Northern's customer base in less than six months, an accomplishment that is virtually unheard of in the utility business absent an acquisition. It is important to note that all of these new customers are buying energy at lower but profit-producing prices. Also, to the credit of the Northern Electric staff, all of Northern's customer satisfaction measures increased from last year notwithstanding the organizational challenges that typically accompany such rapid business growth. We look forward to continuing our customer expansion in the United Kingdom and exporting our capabilities to the United States utility market as it enters deregulation.

Clearly, the Asian economic and currency problems caused enormous dislocation throughout the Pacific Rim and in particular have created significant uncertainty and confusion in Indonesia. Our projects in Indonesia—Dieng, Patuha and Bali—have been impacted by these events. This uncertainty caused us to take a prudent \$87 million, non-recurring



**CalEnergy is committed to its well-defined strategy and ultimately, to providing superior value to the constituents we serve as we continue on our successful path to become a leading global provider of a full range of energy services.**

charge in the fourth quarter of 1997 in order to fully provide for the effect on CalEnergy's investments in Indonesia. However, it is important to note that our U.S. dollar-denominated contracts in Indonesia have sovereign guarantees from the Government of Indonesia and that we have insured our investment on the Dieng and Patuha projects through the Overseas Private Investment Corporation, an agency of the U. S. Government. We have consistently developed our projects with all of the structural safety features we could obtain. The reality remains, however, that significant risk still exists in today's global economy. As such, we will continue to work to protect shareholder value by employing all the protections available.

Our strategy for growth remains focused on the opportunities that continue to unfold in our industry. We plan to utilize our ever-expanding skill base to take advantage of these opportunities, while remaining constantly mindful of the necessity to provide downside protection. I hope the information shared with you in this annual report will provide further insight into our goals and aspirations, as well as a better appreciation of the breadth of our skill base.

Clearly, no one at CalEnergy is satisfied with our stock performance these past months. Although the currency problems in Indonesia have taken a toll on our stock, the decision to invest in Indonesia was made by me in 1993 when it was widely considered one of the Asian 'tiger economies' and these emerging countries were experiencing significant economic growth. In fact, until the third quarter of 1997, Indonesia maintained a strong investment-grade credit rating. As such, I believe compliments are

due to the members of our extraordinary team in Asia, who have discharged their duties with diligence and enthusiasm. Our employee team around the world continues to be one of our greatest assets.

By many companies' standards, CalEnergy's performance in 1997 was very good, although by our own standards we are disappointed. However, we are excited about the potential for CalEnergy's future growth and look forward to a year of strong financial performance in 1998.

I would like to close by thanking our shareholders for their continued confidence, our Board of Directors for their guidance and leadership, our employees for their exceptional performance, and finally to our customers for their trust in us. We remain focused on satisfying their needs and providing reliable and low-cost energy services. CalEnergy is committed to its well-defined strategy and ultimately, to providing superior value to the constituents we serve as we continue on our successful path to become a leading global provider of a full range of energy services.



**David L. Sokol**  
*Chairman of the Board and  
Chief Executive Officer*

# Opportunity

1980

## CalEnergy's Strategic Growth

*CalEnergy extended its operations and entered into an agreement to develop geothermal resources at the Coso project, near China Lake, California.*

# Opportunities for CalEnergy

**Industry change was imminent** in the U.S. For decades, utilities had met increasing power demands with decreasing prices but important events began to take place to change that trend: the Northeast Blackout of 1965 raised concerns about reliability; the passage of the Clean Air Act of 1970 and its amendments in 1977 required utilities to reduce air emissions; the Arab Oil Embargo of 1973-74 resulted in increased fossil-fuel prices; the accident at Three Mile Island in 1979 led to higher costs and uncertainty in the nuclear industry; and inflation caused interest rates to more than triple.

**The momentum grew with the passage of PURPA**, the Public Utility Regulatory Policies Act, passed by U.S. Congress to reduce the country's dependence on foreign oil and promote conservation by encouraging the efficient use of fossil fuels and the development of renewable and alternative energy sources. PURPA created a new category of non-utility generators—small independent power producers—from which utilities were required to buy power.

1960s } 1970s

1971

1978

1979

**CalEnergy was founded as a consultant and developer of geothermal power production facilities in North America.**

**CalEnergy recognized the opportunities presented by PURPA—the first step toward industry deregulation in the U.S. The Company began the transition from a service provider to an independent power producer.**

## A Chronology of Expanding

# A Changing Industry Creates Opportunities

Around the world, energy is a necessity. We need it for heating, cooking, lighting, refrigeration, transportation, and numerous other basic and luxury items. And as economies around the world continue to expand, so does the importance of energy. With economic growth comes an increased demand for energy. In industrialized nations, the growth of energy demand may be tempered by the development of energy efficient technologies, waste reduction, conservation, and better demand-side management plans. Developing nations, however, are witnessing massive growth in energy demands as their newly liberated economies expand.

Since 1991, CalEnergy has studied the impact of increasing global industrialization and population growth on the energy industry. The emerging global marketplace presents many opportunities for agile and astute power providers and energy suppliers. Based on these opportunities, CalEnergy has made strategic decisions and implemented a well-formulated plan to allow us to grow from a developer of geothermal power production facilities in North America to one of the world's leading independent providers of power and energy-related services.

## **A Brief History of the Energy Industry In the United States...**

The early structure of the electricity industry required that the generation, transmission, and distribution of electricity be managed by a primary provider. In some countries, this role fell to the government. In others, primarily industrialized nations like the U.S., exclusive franchises and associated monopolistic power were placed in the hands of utility companies. Because of this monopolistic power, regulation of utilities was a necessity. Although not necessarily assuring quality service and low prices, regulation generally provided reliability to consumers and a guaranteed rate of return to the utilities.

## **Around the World...**

Other nations have similarly experienced the effects of industry changes brought about by shifting social, political and economic factors. In 1989, the U.K. introduced legislation to privatize and deregulate its national electric industry and thereby promote competition. Statistics indicate that since that time, services have improved while the real price of electricity has fallen. Customers in the U.K. are currently paying 33 percent less than consumers in Continental European countries that have not yet undergone privatization. With the end of the Cold War and the consequent opening of economic markets worldwide, countries in Europe, Asia, and South America began efforts to privatize and deregulate their national electric systems.

Today, many states in the U.S. have enacted legislation to ensure full-scale retail electric competition by the year 2000. Countries around the world are looking to privatization and deregulation to help meet the increased energy demands presented by population and economic growth. The industry continues to evolve as full-scale deregulation and privatization occurs around the world. Opportunities for power providers and energy suppliers will continue to expand, especially for companies like CalEnergy that possess the experience and skill base to respond efficiently to the needs of consumers in competitive environments.

**Open commerce flourished worldwide** with the end of the Cold War and the fall of the Berlin Wall. In the U.K., the Electricity Act was introduced to privatize Britain's national electricity industry and promote competition. As the U.S. and the former U.S.S.R. began to decrease financial support to developing nations, those countries realized the need to overhaul their energy industries. Most adopted privatization measures to help satisfy increasing energy demands.

**The pace of industry change worldwide quickened** when the U.S. Energy Policy Act was passed confirming that the U.S. was entering the early stages of deregulation.

**The Philippine government encouraged private investment** by enacting Build-Own-Operate-Transfer laws after suffering billions of dollars of costs associated with brownouts.

1987

1989

1990

1991

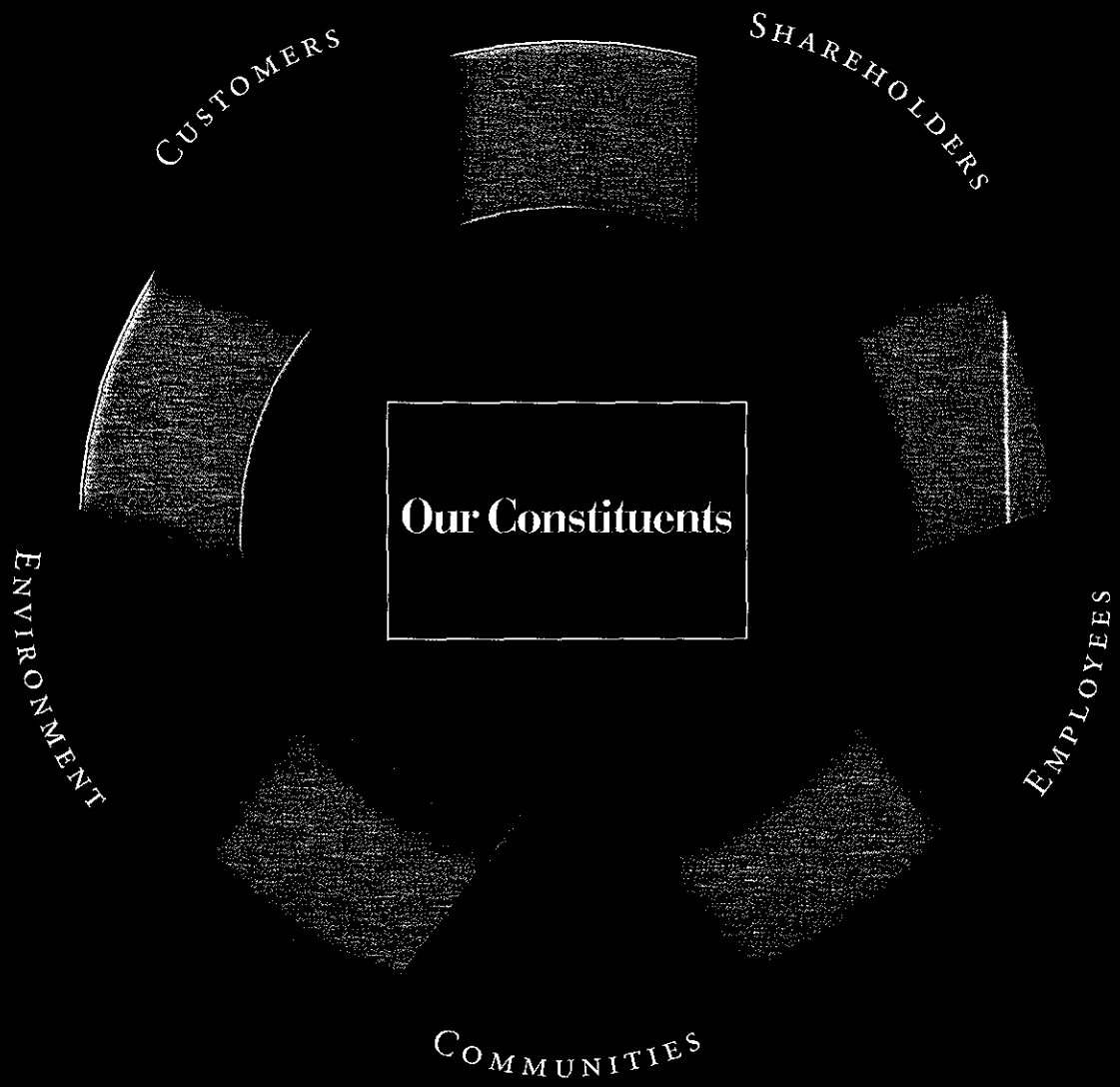
1992

1993

CalEnergy prepared to enter the global marketplace and formulated its strategic plan to include additional energy sources and explore opportunities in Asia. The Company also acquired assets of U.S. geothermal facilities - Desert Peak and Roosevelt Hot Springs, formed a strategic alliance with Kiewit Energy, relocated corporate headquarters to Omaha, Nebraska, installed a new management team and reduced administrative overhead expenses by more than 50 percent.

CalEnergy began commercial operations with its first geothermal power project, Navy I.

CalEnergy moved into international markets with the signing of two energy contracts in the Philippines and obtaining the development rights for two Indonesian geothermal fields. Fuel diversification efforts began with the construction of a natural gas cogeneration facility in Yuma, Arizona and the management team began to keep a watchful eye on the deregulation of the energy industry in the U.K.



**With the passage of the Gas Act**, the U.K. introduced full-fledged competition into the residential gas market which had previously existed in the commercial and industrial sectors. The eventual deregulation of the entire natural gas market in the U.K. is scheduled to take place in 1998.

**Future opportunities are nearly limitless** as more markets around the world open to competition. Opportunities for those in the energy production, supply and services business will compound at an astounding rate. The U.S. market alone is estimated to be \$200 billion and worldwide opportunities could reach nearly a trillion. Companies equipped with the experience and resources to rise to the challenges of these emerging markets will obviously have significant opportunities.

1994

1995

1996

1997

Future

**CalEnergy continued to increase its skill base** by becoming the largest independent geothermal power producer in the world with the acquisition of Magma Power Company. The acquisition doubled CalEnergy's generating capacity and significantly increased its asset base. Construction began on Salton Sea IV at the Imperial Valley, and a Minerals Extraction pilot project was established. The Company continued to strengthen its management team and access to capital markets, and further explored strategic acquisitions that would enable growth.

**CalEnergy is prepared to take full advantage of the opportunities and our vast and solid experience forms the foundation from which we will move forward. We intend to continue to seek out and act on opportunities that make financial sense for our shareholders—those that will allow our Company to grow and prosper.**

**And in 1997... CalEnergy completed construction on two geothermal projects in the Philippines and acquired gas assets in diverse locations such as Poland and Australia. In the U.K., CalEnergy has pursued opportunities presented by deregulation of the gas industry and has attracted nearly 300,000 new gas customers. The Company also agreed to acquire the interests of Kiewit Diversified Group in various international projects, a 30 percent interest in A-rated Northern Electric, and 30 percent ownership interests in CalEnergy's common stock. The transaction will be immediately accretive to earnings in 1998.**

**CalEnergy expanded further as it commenced construction on geothermal projects in the Philippines, signed an historical agreement to construct a combined hydroelectric and irrigation project at the Casecan River in the Philippines, and reached agreements to develop geothermal fields in Indonesia. In the U.S., the Yuma facility became operational and negotiations began to acquire the assets of Magma Power Company, a U.S.-based geothermal power producer.**

**CalEnergy diversified its fuel sources through the acquisition of the assets of Falcon Seaboard Resources, including three natural gas cogeneration plants and a related natural gas pipeline. The Salton Sea IV geothermal project began commercial operation, construction was completed on Malitbog Unit I and Upper Mahiao geothermal projects in the Philippines and construction began on Dieng Unit I geothermal project in Indonesia. Additionally, the Company acquired the remaining 50 percent ownership of four geothermal projects in the Imperial Valley.**

**The Company turned its focus to Europe and acquired majority ownership of Northern Electric in the U.K. The acquisition expanded CalEnergy's skill base to include distribution and supply of electricity and gas, gas exploration and production, sophisticated information technology, and related energy activities. These skills, obtained in a competitive environment, will be applied in the U.S. and other markets embracing deregulation and privatization.**

# CalEnergy is Poised to Reap the Benefits

In developed nations, the deregulation of other industries—notably the telecommunications and airline industries—has paved the way for the deregulation of the energy industry. Shopping for electricity, much in the same way consumers do for long distance telephone services and air transportation in the U.S., is already a consumer reality in the U.K. (where CalEnergy's Northern Electric subsidiary is thriving), and will almost certainly become the norm throughout the U.S. We believe deregulation will bring an end to the monopolies, protected markets, and fixed pricing structures that currently rule the U.S. electricity industry. Lower prices for consumers will be an inevitable result.

Specifically, deregulation alters the complexion of the electricity industry by "unbundling" the trio of functions traditionally performed by utilities. Generation, transmission, and local distribution of power become separate business activities. In a fully deregulated environment, utilities, independent power producers and power marketers can offer electricity to consumers anywhere as a result of open access to the transmission grid.

In the deregulated arena, price is not the customer's only basis for choosing a power supplier. Diverse product offerings, improved customer service, conservation programs, energy-efficient product innovations, and non-fossil fired, renewable 'green' power generation (such as geothermal) are among the options offered by energy providers that seek to gain a competitive edge.

## **With an Eye to the Future**

Historically, CalEnergy has conducted extensive research and made numerous capital commitments to improve the efficiency of its power projects—investments that will allow us to compete successfully in a deregulated environment. Efforts are now underway in the U.S. and elsewhere to ensure that a deregulated electricity industry will provide for and encourage renewable and environmentally responsible energy sources. CalEnergy's long-time commitment to environmental responsibility and our leading position as a geothermal power producer provide additional opportunities in this area.

To sharpen our competitive edge, the Company continues to invest in and implement sophisticated technology to increase operating efficiency, reduce overall costs and protect the environment. Operational excellence and the experience of a top-line employee team contributes to our success.

Because of the Company's presence in progressively privatized and deregulated marketplaces—such as the U.S., U.K., the Philippines, Indonesia, Poland, and Australia—we have gained considerable experience in both the wholesale and retail environments.

All of this equates to a strong foundation from which CalEnergy is well positioned to excel in the deregulated and privatized global energy markets of the future.



Our **commitment to our constituents** is the catalyst for our success. [ ¶ ] Our commitment to our **customers** is to deliver them reliable energy from diversified fuel sources such as geothermal, hydroelectric and natural gas, in addition to offering competitive prices and a full range of innovative and valuable energy services. [ ¶ ] It is because of this dedication to our customers that we are able to create value for our **shareholders**. Our net income available to common shareholders<sup>3</sup> has increased at a compound annual rate of approximately 60 percent over the past three years. [ ¶ ] Equally important is that our **employees** also share in our success.

## Commitment to Our Constituents

Our employees are our most valued asset and we reward their service with competitive compensation and benefit packages, and maintain a safe and healthy work environment. [ ¶ ] We also believe it is our obligation to support the **communities** in which our employees live and where we do business. We express our appreciation by hiring from the local work force and donating to the arts, community charities and outreach programs, and through the sponsorship of educational, safety, and environmental programs. [ ¶ ] Finally, since the founding of our Company we have maintained a commitment to protecting the **environment** through the production of energy from environmentally responsible sources. We remain focused on our continued environmental stewardship.

<sup>3</sup> Before extraordinary item and non-recurring item.

## Our Commitment

*The Power to Make a Difference*

**CalEnergy is committed** to doing its part to bring about increased opportunities and an **enhanced quality of life** to all of our constituents around the world—our **customers, shareholders, employees, and the people of the communities** we serve. We believe that as our Company grows, it is important to provide identifiable benefits to these groups, **whose successes parallel our own.**

### The Impact of Electricity

Although electricity only provides 13 percent of today's end-use energy worldwide (17 percent in industrialized countries)<sup>4</sup>, to most of us energy is electricity. It contributes to our quality of life and directly impacts our ability to make a living.

In developed nations, electricity is readily available. It is generated in many ways—from renewable sources such as geothermal, solar and wind energy to massive plants powered by nuclear fission, or the combustion of fossil fuels like oil, gas, or coal. From there, it is delivered to end users through an extensive system of transmission lines, transformers, and distribution wires running into factories and homes. With the flip of a switch, electricity powers everything from small appliances to large factories.

In many parts of the world, however, electricity is not a fact of life. A vast majority of the population of developing countries have little or no direct access to commercial energy of any form. Basic energy is often derived from heat generated by the burning of coal, wood, or other items. Although developing countries currently comprise 77 percent of the world's population, they use only a quarter of the world's energy. This disparity, of course, is rapidly changing. It is anticipated that electricity will fuel much of the developing world's energy demand for

the next 30 to 40 years, with coal-burning plants, hydropower and other alternative energy processes expected to become primary generation sources.<sup>5</sup>

At CalEnergy, we understand that the various countries and communities we serve have different economies and lifestyles and, therefore, different energy needs. We are gratified to provide a product that has a positive impact on nearly every aspect of life. Access to viable energy supplies will surely help bring about enhanced living standards in less developed parts of the world through increased employment opportunities and economic development, higher levels of education, and better public health. In both emerging and industrialized nations, advanced technology employed by responsible power generators will help reduce air emissions and lessen the impact of a growing population on the environment.

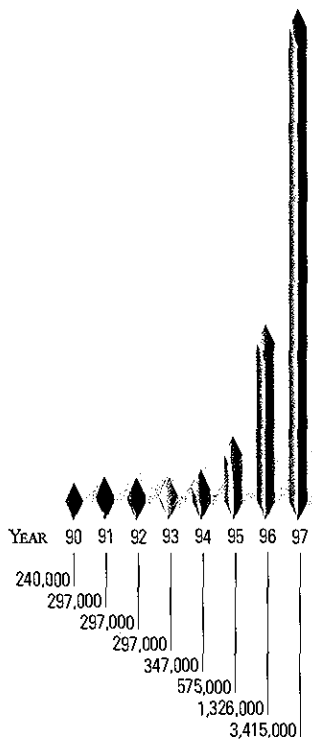
<sup>4</sup> *Looking Ahead—Dealing with Disparity in the Developing World*, Barry Lewis, Science Writer, Environmental Associates, Academy of Natural Sciences, July, 1997

<sup>5</sup> *Ibid.*

**The Benefits to our Customers**

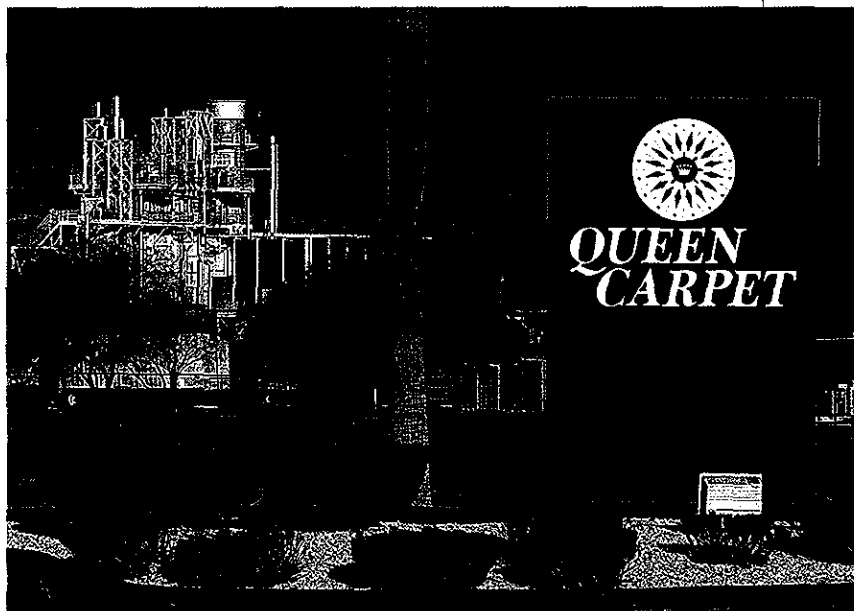
More than anything, our customers create our future opportunities. Their needs affirm the efforts we make on their behalf.

**In the United States**, we are proactive in our efforts to help bring about full deregulation, thus enabling our current and potential customers to choose their energy suppliers. The challenge ahead for power producers in the U.S. and other industrialized nations is to navigate through deregulation and more competitive pricing structures while satisfying customer demands for increased services and environmental stewardship. We believe that customers will look to suppliers who are not only reliable but who also offer competitive prices and a full range of services. Because of our successful experience as a supplier of both electricity and gas in the U.K., CalEnergy already has the processes in place to serve customers optimally in a competitive market.



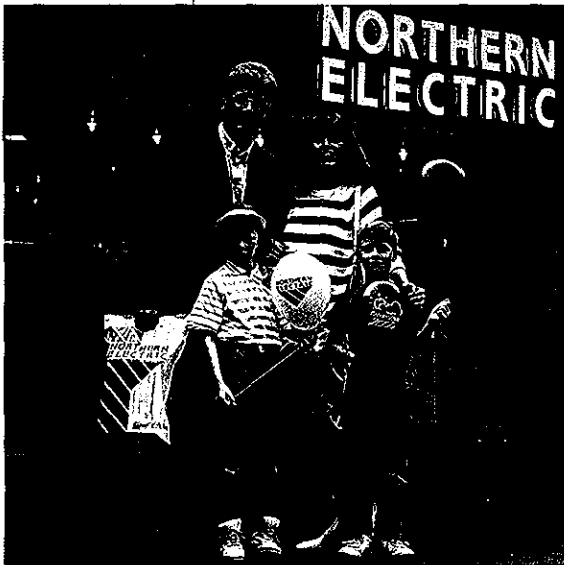
**HISTORICAL GROWTH IN NUMBER OF CUSTOMERS**

*Based on CalEnergy's net megawatts of projects in operation and calculated using electricity industry standards that estimate one megawatt serves 1,000 end-users/customers. 1997 figures reflect the addition of Northern Electric's electricity and expanded gas customer base.*



*A carpet manufacturer utilizes a portion of the steam from Yuma's natural gas cogeneration facility during its processing of nylon into carpet fibers.*

**In the United Kingdom**, our customers are, for the most part, end users of the electricity and gas we provide. Whether these customers are industrial or residential users, we are committed to providing them with premium products and service options, low prices, and responsive customer service. Northern Electric has formed creative alliances and partnerships, and has developed its proven and proprietary information technology and customer billing services network to better meet its customers' needs and to serve them promptly and accurately. As a result, Northern Electric enjoys a reputation for reliability and integrity.



*Satisfied customers outside one of Northern Electric's retail shops.*

**In other parts of the world**, we continue to be committed to completing construction of our projects on time and within budget. Our facilities in the Philippines have already added 500 net MW of generating capacity for the country, and will add an additional 150 net MW of much-needed electricity and water for irrigation in the future. Our presence in developing markets provides benefits beyond those realized by our primary customers. Not only do we become a sustaining force in the local economy,



*Near the Casecnan hydroelectric and irrigation project, CalEnergy's Jim Stallmeyer stops to visit with local children interested in the medical facility being constructed and donated by CalEnergy staff.*

we also work to help implement processes and technology that will further assist area inhabitants. At our Casecnan facility in the Philippines, for example, excess water diverted from the Casecnan and Denip Rivers will be used to irrigate rice fields. It is projected that the annual impact will be approximately one billion pounds of additional paddy rice per year, a production increase that will help the country achieve its goal of self sufficiency in rice production.

### **The Benefits to Our Shareholders**

We are committed to maximizing the rate of return for our shareholders. We do that by demanding excellence in every aspect of our core business: the supply and distribution of electricity and gas; the provision of top-quality related services; and the development, construction, ownership, and operation of power generation facilities. We continuously strive to serve our current customers better and attract new customers in the wholesale and retail environment, to increase our power generating performance and lower operating costs at our generating facilities, and in general, to develop new, innovative processes and services that will allow our Company to expand successfully.

We apply this same level of diligence to every endeavor that supports our core business activities. CalEnergy is known for its ability to assemble innovative, well-structured financing packages that enable us to reduce risk. We have obtained more than \$7 billion in financing since 1991, and have completed project financings for major international projects utilizing a variety of sources including capital markets, commercial banks, and multilateral and export credit agencies such as the Overseas Private Investment Corporation and the Export-Import Bank of the U.S.

As we strive to be one of the lowest cost independent power providers, CalEnergy generates attractive rates of return on our invested capital. We have also achieved much better than average growth in Northern Electric's gas supply business. Our experience with Northern is testament to our ability to act on strategic acquisition opportunities and once completed, realize operating enhancements and cost-saving measures to allow our Company to grow and our shareholders to prosper.

### **The Benefits to Our Employees**

The working environment at CalEnergy is one of professionalism and commitment to integrity in everything we do. The hours are long and the work is challenging and complex, yet an atmosphere of camaraderie and teamwork exists that moves us forward. Without the competence, knowledge, and fortitude of our employees and the willingness of many to travel and immerse themselves in new cultures, our Company would have been unprepared for the rapid growth and expansion we have experienced over the last five years. CalEnergy employees truly are the driving force behind the success of our Company and we applaud their dedication, diligence and hard work. We provide competitive compensation packages, medical and dental programs, life insurance programs, accidental death and disability insurance plans, and many opportunities for incentive compensation.

We believe in promoting from within whenever possible and providing our employees with additional training and educational experience to equip them for promotional opportunities. We provide tuition reimbursement assistance and reimbursement for obtaining professional certifications.

The safety of our employees is also of top priority. Safety, wellness and productivity workshops are consistently conducted at each of our facilities worldwide. *We believe it is our duty to send our employees home in the same manner in which they come to work—safe and healthy.*

### **The Benefits to Our Communities**

The success of the communities near our facilities is important to us for many reasons, but primarily because they are the homes of our customers and employees. We are proud of the volunteer efforts of our employees, who tirelessly donate their time to many charitable organizations around the world. As an organization, we strongly believe it is the obligation of our Company to give something back to the people of the communities that sustain us. In that regard, we hire from the local workforce, support the arts and community charities, and actively participate in educational organizations, community safety programs, and environmental activities.



*The Leathers power project produces electricity solely from naturally occurring geothermal steam near the Salton Sea Known Geothermal Resource Area in Southern California's Imperial Valley.*



*As part of CalEnergy's Community Relations Program more than 13,600 educational text books and science kits were collected and shipped to schools and libraries on the island of Leyte in the Philippines for use by local school children.*

In the communities in emerging nations where many of our projects are located, there is a need for non-traditional assistance. We help by providing support in the form of medical, nutritional, educational, and other types of aid. We have assisted in the building of roads, schools, and medical facilities, and by providing food, potable water, agricultural and transportation equipment, and other basic supplies.

**In the United States**, CalEnergy supports charitable and civic organizations, the arts, and educational and environmental activities across the nation. Many of the Company's facilities are the largest supporters in their communities of organizations like the United Way. Company employees donate their time and resources to organizations including the Cystic Fibrosis Foundation, the Muscular Dystrophy Association, area Chambers of Commerce, the Boy and Girl Scouts of America, 4H, local blood banks, homeless shelters, safe havens for abused women and children, and drug prevention

organizations. Nearly all of our facilities have programs in place to partner with area schools, to support school activities, athletic and scholarship programs, provide financial and equipment donations, and volunteer time to help educate students about career opportunities and environmental issues.

As one example of how CalEnergy employees from different areas interact and support one another, CalEnergy corporate staff members worked closely with CalEnergy's Leyte Operations in the Philippines in 1997 on a program to provide text books to schools and libraries on the island of Leyte in the Philippines. The CalEnergy staff in the U.S. joined with the Omaha Public Schools, Team Air Express, and the Filipino-American Youth Organization to collect and ship more than 13,600 educational text books and science kits to the schools on Leyte. It is anticipated that this successful and gratifying program will continue for years to come.

In 1997, our Imperial Valley employees were recognized by the U.S. Fish and Wildlife Service for helping to construct and provide electrical wiring for a medical and surgical hospital unit, used for the treatment of ill and injured pelicans, cranes, and other birds.

In other environmental efforts, CalEnergy was a major sponsor of "Earth & Us," a public television outreach alliance project. The community educational project, initiated in 1997, spans 12-18 months and focuses on water quality in the watersheds of Lake Champlain and the upper St. Lawrence River Valley, near our Saranac facility where we maintain a significant wetlands acreage. Elements of the project include workshops for educators, the distribution of information about how residents can work to affect and improve water quality, and a series of community events.

**In the United Kingdom,** CalEnergy's subsidiary, Northern Electric, is one of northeast England's largest charitable contributors, sponsoring and supporting a wide range of agencies, charities, voluntary groups, causes, and community programs. Northern Electric has put a special emphasis on education and training, new enterprise, and opportunities for people with special needs. Northern Electric helps bring the Royal Shakespeare Company to northeast England every year, and also supports home-grown artistic and athletic development through its sponsorship of the annual Northern Electric Arts Awards and the Northern Electric Foundation for Sport.

In partnership with the conservation charity Tusk Force, a group known for its protection of endangered species, the Northern Electric Conservation Awards program was launched in October 1997. The program is open to young people between the ages of five and 16, and is intended to increase conservation awareness. Participants must complete five conservation challenges by May of 1998. More than 2,000 schools in the region have been invited to participate in the program.

Additionally, Northern Electric employees donate to approximately 40 local organizations and charities in northeast England each year through its Charitable Payroll Giving Program, which collects funds through payroll deductions elected by employees and retired staff. These funds are then distributed to worthy organizations. In October, the Charity Association presented a check to the Northumberland Cancer Support Group, which offers support and advice to cancer sufferers and their families throughout the area. In November, the staff donated state-of-the-art exercise equipment to the Cardiac Rehabilitation Unit of South Shields District General Hospital in South Tyneside, which will help cardiac patients with their rehabilitation after illnesses or surgical procedures.



*In an effort to increase conservation awareness, Northern Electric launched its first annual Conservation Awards program for young people between the ages of five and 16.*

**In the Philippines**, we have been involved in many cultural, educational, and environmental activities. Near our Casecnan project, we have been actively involved in improving the standard of living of the Bugkalots, indigenous people who live in the surrounding area. We have established a Civic Action Plan to provide for a shuttle bus and the building of a road to enable them to travel from their homes and through the mountains to a nearby village. We have also provided agricultural training and educational programs, and have established a scholarship program to help further educational opportunities.

Also in the Philippines, CalEnergy helped to fund the "Presidential Derby '98," an event organized by the Harvard KSG Foundation to promote the democratic process and educate voters about candidates in the presidential election to be held in March of 1998. Eight hundred people including politicians, business leaders, and media representatives attended the forum to hear five of the top eight presidential candidates respond to questions on pertinent issues. The event was widely reported in the newspapers of the Philippines and throughout Southeast Asia, and was the subject of a national telecast.

**In Indonesia**, on the island of Bali, CalEnergy initiated a recycling program in 1997 in the villages of Desa Candikuning and Desa Pancasari in the Bedugul area. The program will help the villages begin recycling and managing solid waste, and educate and involve local students in the recycling effort. In addition to building a recycling center, CalEnergy provided trash bins for the communities and the schools, donated a pickup truck to haul the recycling material and trash, and is making donations to support recycling education and a trash clean-up program involving the village schools. We also provided trash containers for the Kebun Raya tourist area to help control litter.

### **The Benefits to Our Environment**

Past industry-wide power generation practices have accounted for nearly one-third of global emissions of carbon dioxide, which is believed to be the principal 'greenhouse gas.' These past practices have also been blamed for producing nearly two-thirds of the sulfur dioxide that is a major culprit in air pollution. Additionally, the power industry has been implicated in other environmental problems ranging from heat emissions into air and water supplies to the emission of toxic wastes. Therefore, it is critical that participants in the energy industry become better stewards of the environment and impose safeguards to prevent and reduce harmful emissions.

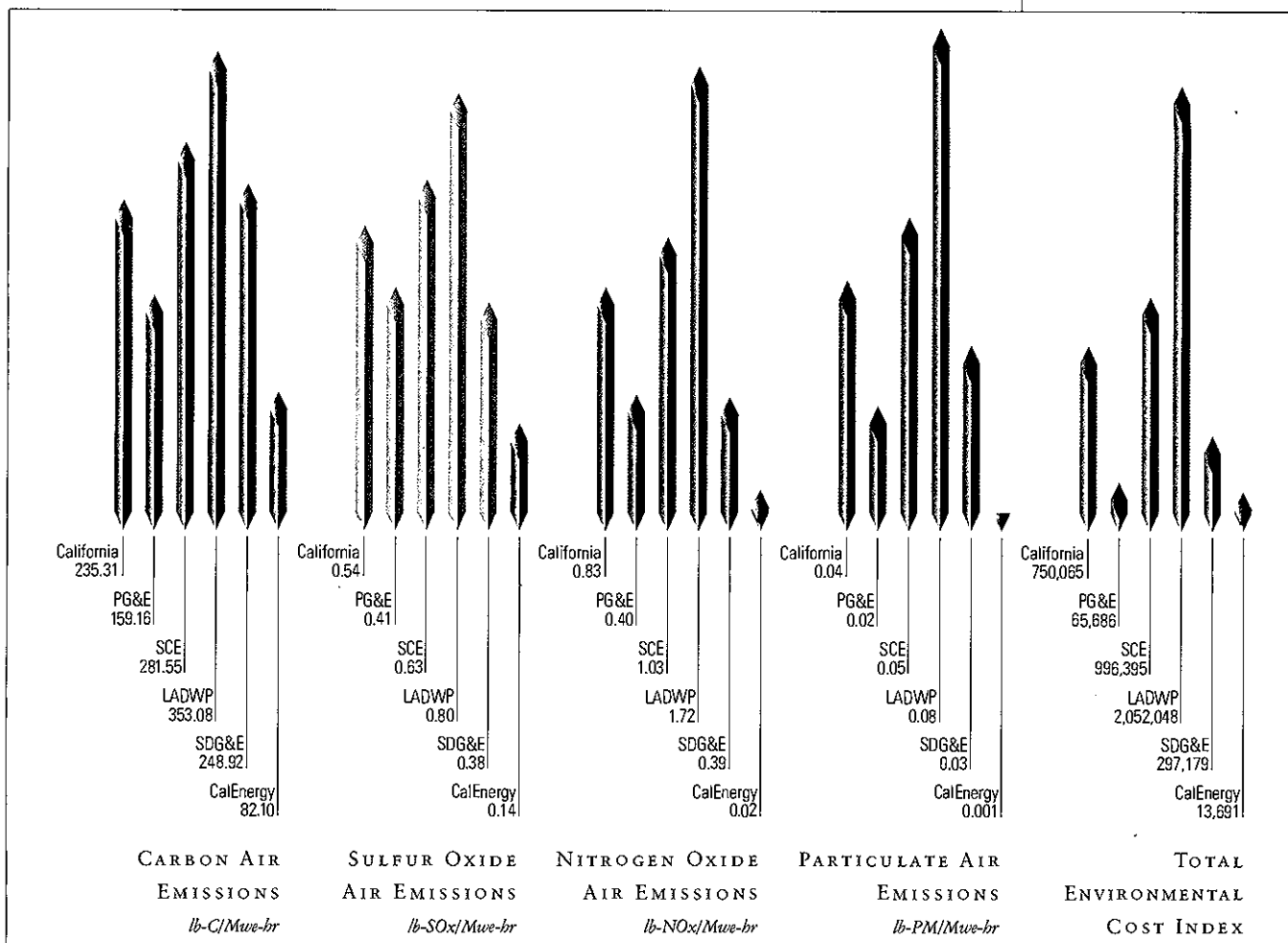
CalEnergy has continued to focus on providing clean, renewable energy since its founding in 1971. During the past 26 years, we have employed the most up-to-date technology at our facilities to ensure a minimal impact on the environment. The primary fuel sources utilized by CalEnergy—geothermal, natural gas, and hydroelectric—are advantageous in this regard.

Geothermal energy is clean, reliable, renewable and indigenous. Natural gas is one of the cleanest fossil fuel sources in the world—plentiful, economical and highly efficient. Hydroelectric power, produced from the energy of flowing water, is also from a renewable, dependable, clean source when properly implemented.



*A recycling program developed by CalEnergy on the island of Bali in Indonesia focuses on educating school children on the importance of recycling and managing waste.*





CALIFORNIA ELECTRICAL SUPPLIERS' GENERATION SYSTEMS: TOTAL AIR EMISSIONS<sup>6</sup> AND ENVIRONMENTAL COSTS<sup>7</sup>

Numbers are based on public information and reflect costs and air emissions per megawatts produced.

### Worldwide Climate Change...

In 1997, CalEnergy became involved with the Intergovernmental Panel on Climate Change ("IPCC"), which includes 2,500 climate experts from around the world. The mission of the IPCC is to promote climate change policies that will provide incentives to reduce greenhouse emissions and other threats to our global climate. CalEnergy continues to be an active proponent of emission reductions.

*As indicated by the chart above, major findings illustrate that there are significant differences in the major California electrical suppliers.*

*CalEnergy compares very favorably with other suppliers because of our low impacts of air emissions and low total environmental cost index.*

As world population continues to increase at a rapid pace, it becomes even more important to preserve our natural resources and reduce

the effects of pollution and global warming.

CalEnergy remains committed to:

- ▶ *reducing and, wherever possible, eliminating environmental impacts*
- ▶ *re-using and recycling materials, wherever possible*
- ▶ *promoting energy conservation and efficiency*
- ▶ *improving public awareness of environmental issues*
- ▶ *ensuring full compliance with legislation and regulation*
- ▶ *refining our environmental management system*
- ▶ *broadening our efforts to meet increasing energy demands by utilizing clean, reliable, and economical fuel sources*
- ▶ *employing environmentally responsible technology*

*California: Yearly average fuel mix in the State of California*

*PG&E: Pacific Gas & Electric*

*SCE: Southern California Edison*

*LADWP: Los Angeles Department of Water & Power*

*SDG&E: San Diego Gas & Electric*

*CalEnergy: CalEnergy Company, Inc. (Coso, Imperial Valley, Desert Peak and Yuma)*

*W.B. Goddard, Ph.D. and C.B. Goddard, M.A.*

*Goddard & Goddard Engineering—Environmental Studies (G&GE, 1998)*

<sup>6</sup> All air emissions are defined as pounds ("lb") of pollutants per megawatts of electric ("Mwe") hours produced.

<sup>7</sup> Estimated Electrical Suppliers' Generation Systems input energy content, capital costs, land disturbance and external costs per megawatt electric.

DEVELOP,  
CONSTRUCT, OWN  
AND OPERATE  
ENVIRONMENTALLY  
RESPONSIBLE POWER  
GENERATION  
FACILITIES

SUPPLY,  
DISTRIBUTION,  
TRANSMISSION  
AND MARKETING  
OF ELECTRICITY  
AND GAS

PROVIDE  
A FULL  
RANGE OF  
ENERGY SERVICES

**Core Business  
Operations**

EXPLORE  
AND DEVELOP GAS  
AND GEOTHERMAL  
FIELDS

COMPETITIVE  
INFORMATION  
TECHNOLOGY  
SERVICES

## Excellence in Core Business Operations

We are committed to **excellence in core business operations**. [ ¶ ] We **develop, construct, own, and operate** environmentally responsible power generation facilities. [ ¶ ] We engage in the **supply, distribution, transmission, and marketing of electricity and gas**. [ ¶ ] We **explore and develop** gas and geothermal fields. [ ¶ ] We provide our customers with a **full range of energy services**. [ ¶ ] We utilize **competitive information technology** and develop innovative customer services to maintain a focus on **operational excellence** in every area of our Company.

Telephone Flat  
Desert Peak  
Coso  
Roosevelt Hot Springs  
Imperial Valley  
Minerals Extraction  
Yuma

Saranac  
NorCon  
CalEnergy Corporate Headquarters  
Power Resources

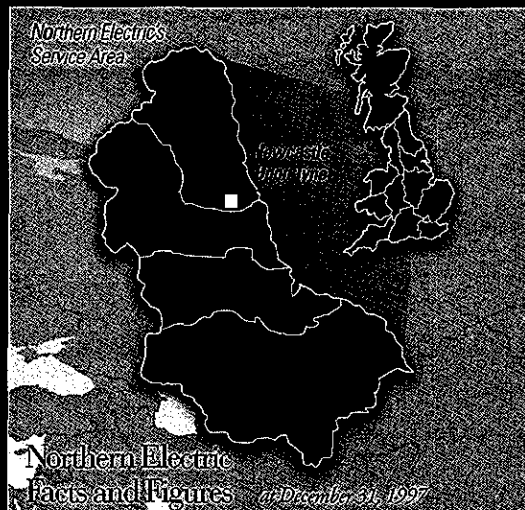
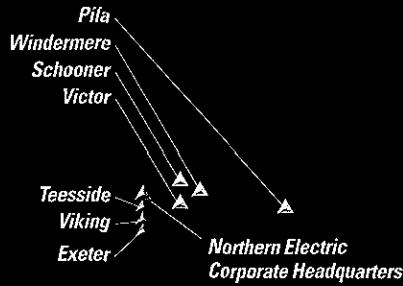
# CalEnergy's Global Portfolio



	Fuel	Net MW	Net MW Owned
<b>United States:</b>			
<b>▲ OPERATIONS:</b>			
<i>Arizona:</i>			
Yuma	Gas	50	50
<i>California:</i>			
Coso Navy I, Navy II, BLM	Geothermal	264	127
Imperial Valley Salton Sea I, II, III, IV, Vulcan, Hoch, Elmore, Leathers	Geothermal	268	268
<i>Nevada:</i>			
Desert Peak	Geothermal	10	10
<i>New York:</i>			
Saranac	Gas	240	180
<i>Pennsylvania:</i>			
NorCon	Gas	80	64
<i>Texas:</i>			
Power Resources	Gas	200	200
<i>Utah:</i>			
Roosevelt Hot Springs	Geothermal	23	17
<b>▲ DEVELOPMENT:</b>			
<i>California:</i>			
Telephone Flat	Geothermal	30	30
Minerals Extraction	Geothermal	49	49
<b>Total</b>		<b>1,214</b>	<b>995</b>

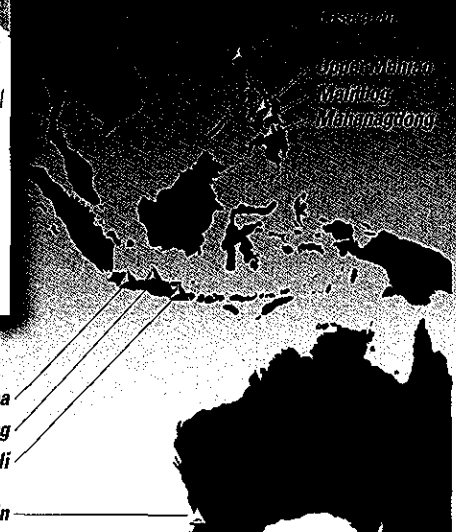
	Fuel	Net MW	Net MW Owned
<b>United Kingdom:</b>			
<b>▲ OPERATIONS:</b>			
Teesside	Gas	1,875	289
<b>▲ CONSTRUCTION:</b>			
Viking	Gas	50	25
<b>▲ DEVELOPMENT:</b>			
Exeter Power	Gas	50	25
<b>Total</b>		<b>1,975</b>	<b>339</b>

*Note: Actual MW may vary depending on operating and reservoir conditions and plant design.*



**Northern Electric Facts and Figures as of December 31, 1997**

Franchise area	14,400 sq km
Resident population	3.2 million
Customers supplied	1.5 million
Distribution network	17,179 km of overhead lines
	26,118 km of underground cables
	24,575 transformers
	16,820 MVA transforming capacity
System maximum demand	2,877 MW
Units of electricity distributed	15,714 GWh
Units of electricity supplied	14,389 GWh
Gas supplied	74.5 million therms



	Fuel	Net MW	Net MW Owned
<b>Philippines:</b>			
<b>▲ OPERATIONS:</b>			
Upper Mahiao	Geothermal	119	119
Malitbog	Geothermal	216	216
Mahanagdong	Geothermal	165	149
<b>▲ CONSTRUCTION:</b>			
Casecanan	Hydro	150	105
<b>▲ DEVELOPMENT:</b>			
Alto Peak	Geothermal	70	70
<b>Indonesia:</b>			
<b>▲ CONSTRUCTION:</b>			
Dieng Unit I	Geothermal	55	52
Dieng Unit II	Geothermal	80	75
Patuha Unit I	Geothermal	80	70
<b>▲ DEVELOPMENT:</b>			
Dieng Phase II	Geothermal	265	249
Patuha Phase II	Geothermal	320	282
Bali	Geothermal	400	240
<b>Total</b>		<b>1,920</b>	<b>1,627</b>

	Share of Remaining Reserves Bcf	Current Percentage Working Interest
<b>▲ PRODUCING GAS FIELDS:</b>		
Windermere	15.0	20%
Victor	12.1	5%
Schooner	11.1	2%
	Size Km <sup>2</sup>	Current Percentage Working Interest
<b>▲ GAS FIELDS IN DEVELOPMENT:</b>		
Gingin Concession	2,960	9%
Pila Concession	13,000	100%

<b>Total Net MW</b>	<b>5,109</b>
<b>Total Net MW Owned</b>	<b>2,961</b>

- ▲ CORPORATE HEADQUARTERS
- ▲ OPERATIONS
- ▲ CONSTRUCTION
- ▲ DEVELOPMENT
- ▲ GAS EXPLORATION

*Note: The Company operates all generation projects other than Teesside. Actual MW may vary depending on operating and reservoir conditions and plant design.*

# Project Overview

## *A Landmark Year*



*CalEnergy's Navy II geothermal project provides royalties to the U.S. Department of the Navy and is located on the Naval Air Weapons Station in the Mojave Desert at China Lake, California.*

Since 1991, our global reach has grown tremendously. In 1997, CalEnergy expanded in several fundamental respects—geographically, in net megawatts of capacity, in experience and skill base. We reached agreements to develop projects in Poland and Australia, respectively. We increased our operating capacity as we completed construction on projects of approximately 300 MW of new geothermal generating capacity in the Philippines. In the U.S., two projects continued in their development phase and our existing operating facilities maintained production at record levels.

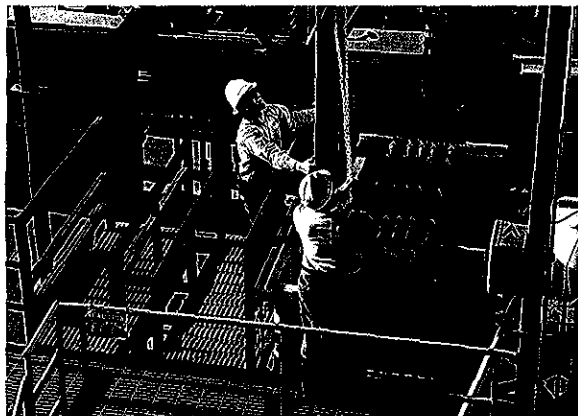
These events come on the heels of an active 1996 during which we began power plant operations outside the U.S. Today, through our experience with Northern Electric in the U.K., we have earned a leading position among companies in competitive power markets in all regions of the world.

### **A Look at Our Projects In the United States...**

Overall performance at our U.S. facilities in 1997 was outstanding. CalEnergy operates 17 geothermal and natural gas-fired cogeneration facilities in the U.S. The Company continues to upgrade these projects and all of its facilities worldwide to maintain our position as a low-cost, reliable power provider in the competitive marketplace.



*Consolidating Imperial Valley's control room operations enables the operators to efficiently monitor several geothermal power projects at one time.*



*Through an electrowinning process, zinc is extracted from geothermal brine for commercial sale at CalEnergy's Minerals Extraction project in the Imperial Valley.*

#### Geothermal Projects:

Geothermal steam is an environmentally preferred energy source because it is reliable, renewable, clean, and economical. Geothermal production wells tap into these superheated systems thousands of feet beneath the earth's surface to release tremendous pressure caused by the hot water flashing to steam. At the surface, the steam is separated from the fluids and used to drive turbines that generate electricity.

Our U.S. geothermal facilities all performed well in 1997. They include: Coso, a 264 net MW project located near Ridgecrest, California; Imperial Valley, a 268 net MW project near Calipatria, California; Desert Peak, a 10 net MW project near Reno, Nevada; and Roosevelt Hot Springs, a 23 net MW project in Utah.

At our Imperial Valley location, CalEnergy is continuing to develop its Minerals Extraction project. This technology involves the use of ion exchange, solvent extraction, and electrowinning to extract and plate minerals from geothermal brine that is brought to the surface during the geothermal power production process. We anticipate that this will be a successful addition to our current operations at this site.

At our Telephone Flat project in northern California, our environmental permitting process continues. The 30 net MW geothermal project is located in Siskiyou County, California.

#### Natural Gas/Cogeneration Projects:

Natural gas is one of the world's most economical, plentiful, thermally efficient and clean fossil fuel sources. CalEnergy's cogeneration facilities use natural gas to fuel the turbines that produce energy in both electric and thermal (steam) form. In simple cycle facilities, waste heat from the turbines is dissipated into the atmosphere. At CalEnergy's cogeneration facilities, however, this exhaust is recycled in a heat recovery process in which high-pressure steam is produced to drive the steam turbine generator. A portion of the steam is then extracted and delivered to a thermal host—a nearby industrial company that uses the steam for processing operations or cooling, thus reducing the operating cost of the plant and optimizing fuel use.

CalEnergy's gas-fired cogeneration facilities include: Saranac, a 240 net MW project located in Plattsburgh, New York; Power Resources, a 200 net MW project near Big Spring, Texas; NorCon, an 80 net MW project in North East, Pennsylvania; and Yuma, a 50 net MW project in Yuma, Arizona.



*The Saranac gas-fired cogeneration project located in Plattsburgh, New York sells electricity to a utility and also natural gas through the Company's North Country Gas Pipeline.*

### In the United Kingdom...

Our acquisition of Northern Electric, on December 24, 1996, is perhaps the most significant move by our Company to date. We are extremely pleased by the performance of Northern Electric, as an electricity supply and distribution company serving nearly 1.8 million customers in all 14 public electricity supply areas of England, Scotland and Wales. Northern is also emerging as a leading gas supplier in the competitive gas market. Effective in 1998, our purchase of the additional 30 percent stake in A-rated Northern Electric from KDG adds to our portfolio.

The acquisition of Northern Electric is consistent with our growth strategy and is important for several reasons. First, we acquired Northern at an extremely attractive price — one of the lowest prices paid for a U.K. Regional Electricity Company. This fact, along with Northern Electric's exceptional performance in 1997, has positively impacted our financial results. Finally, the acquisition has positioned us for growth by providing an experience base from which to compete in other deregulated electric and gas markets.

#### Distribution and Supply:

In 1989, efforts began to liberalize the U.K. electricity industry and in 1998 full competition is expected to commence in both electricity and gas supply. It is significant that Northern Electric operates in a deregulated environment, and this fact was fundamental to our decision to move forward with the acquisition. In addition to building a profitable business in the U.K., we are building a foundation of expertise that will prove invaluable in the U.S. and other markets worldwide as deregulation occurs. Northern has considerable experience and a solid reputation as a dependable energy supplier with excellent distribution abilities.



*Northern Electric operates an extensive microwave communications network in northeast England.*

Known for dependability and competitive pricing, Northern offers its customers a diverse menu of complementary energy services through its subsidiaries:

- ▶ Northern Electric Distribution is responsible for managing the distribution (wires) network.
- ▶ Northern Electric Supply supplies customers with electricity and gas.
- ▶ Northern Electric Generation has ownership interests in and operates power generating facilities.
- ▶ Northern Utility Services is an engineering division responsible for maintaining the distribution network and providing related services to third party markets.
- ▶ Northern Metering Services supplies and maintains meters and provides data collection services.
- ▶ Northern Electric Retail currently owns and operates 41 shops and superstores selling general kitchen-related appliances, home-entertainment products, computers, electric heating and other small appliances, and extended warranties.
- ▶ Additional service companies provide internal and some external customers with real estate, transportation, training, telecommunications, and information services.



Over the last six months of 1997, Northern expanded its supply customer base by 20 percent by attracting nearly 300,000 new gas customers. A successful Dual Fuel marketing program has been introduced to offer customers cost savings for combined electricity and gas services. In addition, annual cost savings of approximately £17 million (U.S. \$27.2 million) have been realized with the successful integration of Northern Electric into our operation.

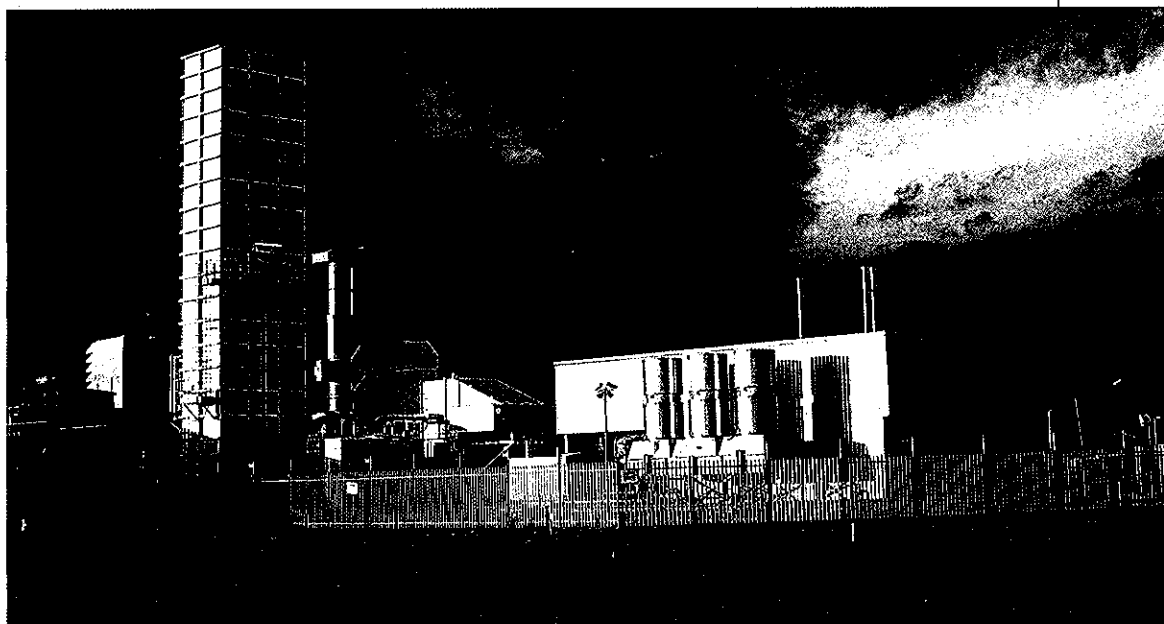
During 1998, deregulation is expected to be completed and competition extended to the remainder of the energy market in the U.K. Approximately 26 million electricity consumers and 20 million gas users will be free to choose their suppliers.<sup>9</sup> This should result in lower prices and higher service standards. In addition to aggressive cost-cutting measures, Northern Electric has implemented key strategies to satisfy customer expectations, retain existing customers, and attract new customers in this competitive environment. These include unique information technology systems that will allow Northern to handle a large number of customers and provide premium service in bill assessment and collection, power outage procedures, and changes in customers.

#### Natural Gas/Cogeneration Projects:

During 1997, construction began at the 50 net MW natural gas-fired Viking Power Station at Seal Sands on Teesside, which is owned 50 percent by Northern Electric and 50 percent by Rolls-Royce Power Ventures. The facility is to be connected directly into the Northern Electric distribution system and has a long-term gas supply/electricity offtake contract with Northern Electric.

Additionally, Northern Electric has a 15.4 percent ownership interest in Teesside Power Limited, which operates a 1,875 net MW combined cycle gas-fired power station at Wilton. Northern Electric purchases 400 MW of electricity from the plant under a 15-year contract.

Northern Electric also operates a 5 net MW diesel power generating plant in Northallerton, North Yorkshire.



*The Viking power station at Seal Sands on Teesside in the U.K. is scheduled to be commissioned in 1998.*

<sup>9</sup> UK Electricity Association

HISTORICAL  
GROWTH  
IN SKILLS

1990



Geothermal  
Exploration &  
Generation

1997

Geothermal  
Exploration &  
Generation



Gas  
Generation

Hydro  
Generation



Electric  
Supply

Gas  
Supply



Gas Exploration  
& Production

Electric  
Distribution



Electric  
Services

**Gas Field Development:**

In order to increase our business opportunities further, CalEnergy seeks to produce not only electricity but also gas for its customers. To achieve this, the Company's subsidiary CalEnergy Gas (U.K.) Ltd. has developed a diversified portfolio of exploration, development, and production assets in the U.K. portion of the Southern Gas Basin in the North Sea. Current production comes from the Company's interests in the Victor, Schooner, and Windermere gas fields, with remaining reserves of approximately 38 billion cubic feet ("bcf") of gas.

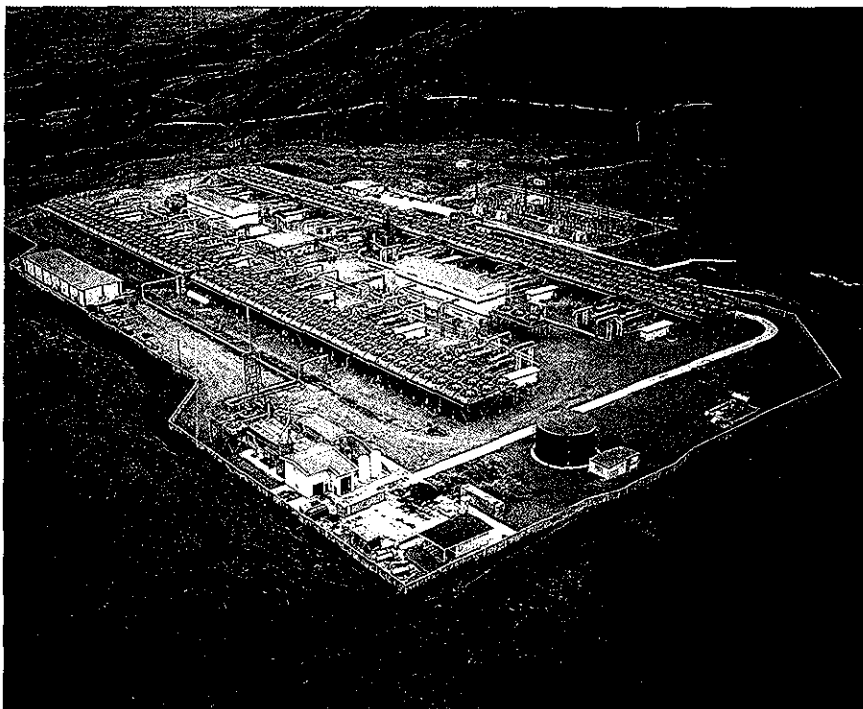
**In Poland...**

Poland's electric power sector is in the process of restructuring into three subsystems: generation, transmission, and distribution. Most power plants there burn coal, and more than half are combined heat and power plants. Currently, Poland's needs relate primarily to improving energy efficiency and competitiveness, and addressing environmental concerns. Natural gas is the preferred substitute for coal, and by 2010 Poland plans to generate at least 10 percent of its electricity with natural gas, as compared with approximately three percent currently.<sup>9</sup>

**Gas Field Development:**

CalEnergy Gas has reached an agreement with the Polish Ministry of Natural Resources for exclusive gas exploration and development rights to a 13,000 square kilometer area in the Central Polish Trough of northwestern Poland. The area, known as the Pila concession, is situated within the geological province of the northwest European Permian Basin. The agreement represents an excellent opportunity for the Company in view of Pila's potential undeveloped gas reserves.

<sup>9</sup> U.S. Department of Energy



*The first CalEnergy Philippine power project to receive revenue was the Upper Mahiao geothermal project located on the island of Leyte.*

### **In the Philippines...**

Although Asia, as a whole, is experiencing economic uncertainties, CalEnergy's projects in the Philippines remain unaffected.

Since 1990, when the Philippine government began enacting Build-Own-Operate-Transfer ("BOOT") laws to encourage increased private investment in the country's power sector, opportunities for independent power producers in that country have been very attractive. Each of CalEnergy's projects in the Philippines is structured as a BOOT project, with ownership transferring to the Philippine government after an agreed upon period of time.

Currently, about 65 percent of the Philippines is electrified and energy demand is increasing. Between 1993 and 1999, approximately 6,000 MW of additional power generating capacity will be added in the Philippines through BOOT contracts. The current Power Development Program foresees total capacity additions of 13,000 MW from 1996 to 2005, 32,660 MW from 2006 to 2015, and 46,500 MW through 2025. Currently, about two-thirds of Philippine electric generation capacity is oil or coal, with the remainder based on geothermal and hydroelectric sources.<sup>10</sup>

The Philippines possesses significant geothermal capacity, and the hydroelectric power potential in the country is also vast. CalEnergy's current projects in the Philippines consist of three geothermal power facilities and one combined irrigation and hydroelectric power generation project. The country's major long-term goal is to diversify its power generation mix by encouraging the development of new and renewable energy sources, such as those employed by CalEnergy.

After the National Power Corporation ("Napocor") completed its transmission line interconnections to Cebu, Republic of the Philippines President Fidel V. Ramos and members of his cabinet conducted a site tour of CalEnergy's Upper Mahiao geothermal plant.

His inspiring message during this tour underscored the importance of the completion of the BOOT projects and his commitment to increasing the electrical infrastructure of the Philippines using its own environmentally friendly natural resources. President Ramos cited the fact that operation of the Leyte geothermal plants displaced the need to import 9.4 million barrels of oil per year, resulting in a savings to the Republic of the Philippines of approximately \$142 million per year.



<sup>10</sup> *Ibid.*

The President also noted that the development and operation of the plants was an excellent example of the type of private sector and government cooperation that the BOOT program was intended to foster.

#### Geothermal Projects:

The construction of CalEnergy's Malitbog Units II and III and Mahanagdong geothermal projects were deemed complete in July 1997. The Malitbog project is a three-unit, 216 net MW facility on the Tongonan Geothermal Reservation on the island of Leyte. Our Mahanagdong project is a 165 net MW geothermal facility also located on Leyte. Both facilities sell 100 percent of their capacity to the Philippine National Oil Company-EDC ("PNOC-EDC").

During its first year of operation our Upper Mahiao project, a 119 net MW geothermal power project, performed exceedingly well. The project was deemed complete in June, 1996.

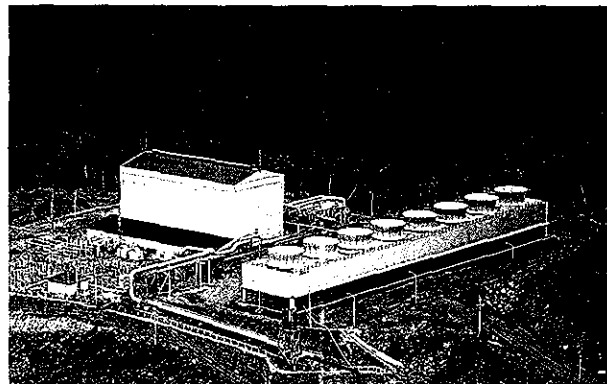
#### Combined Irrigation/Hydroelectric Project:

Construction is progressing at the Casecan project site. The project is the result of an agreement between CalEnergy and the Philippine National Irrigation Administration to develop a combined irrigation and hydroelectric power generation project that will divert excess water from the Casecan and Denip Rivers in Northern Luzon through an approximately 23-kilometer tunnel to the generating plant.

The project will provide up to 150 net MW of new, installed hydroelectric capacity to the important Luzon electrical grid as well as much-needed water for agricultural use in the Luzon Valley.

#### In Indonesia...

The situation in Indonesia has created some significant challenges for the Company, requiring us to record an \$87 million non-recurring charge in the fourth quarter of 1997. We are proceeding cautiously and are actively pursuing the resolution of the issues involving our Indonesian projects in order to protect our shareholders' economic interests.



*Completed in July 1997, Mahanagdong Site B utilizes environmentally responsible geothermal fuel to supply power to the Philippine National Oil Company.*

**President Ramos** cited the fact that operation of the Leyte geothermal plants **displaced the need to import 9.4 million barrels of oil per year**, resulting in a savings to the Republic of the Philippines of approximately **\$142 million per year**.

Nevertheless, it is important to note that less than five percent of the Company's total assets are invested in Indonesia and that we intend to continue to take all actions necessary to ensure our contracts are honored by the Government of Indonesia.

Additionally, realizing that one component of CalEnergy's overall strategy is the development of projects in emerging countries, it should be understood that these economies typically experience periods of success and periods of setback. With that in mind, and because it is impossible to predict long-term economic cycles, CalEnergy's projects in emerging regions have been and will continue to be structured to minimize risk to our Company. To this effect, we have consistently obtained political risk insurance for our investments and sovereign guarantees for our projects in Indonesia. In addition, our payments in accordance with our contracts, are in U.S. dollars and therefore are not directly affected by local currency fluctuations.

It is also important to note that our global expansion is not reliant on one economy for growth as we have diversified our overseas investment portfolio.

As in the Philippines, rapid economic growth in recent years has increased the demand for electricity. Indonesia currently has the fourth largest population base in the world, with more than 200 million people. To satisfy the increased demand and help stabilize energy costs, it is important that electricity in Indonesia be developed from sources that are reliable, renewable, clean, indigenous, and economical.

Indonesia has a wealth of geothermally active areas and has identified a geothermal power-generating potential of 16,000 MW. As in the Philippines, our projects in Indonesia are structured as BOOT projects whereby, after an agreed upon period of time, ownership will transfer from CalEnergy and its partners to the Indonesian government.



*Construction is proceeding on the Trailrace facility at the Casecan combined hydroelectric and irrigation project located in Northern Luzon in the Philippines.*

### **In Australia ...**

In Australia, the national government's deregulation of the natural gas sector has spurred privatization and construction of natural gas pipelines. These efforts are helping to create an interstate gas grid that will further competition in the gas sector.

#### **Gas Field Development:**

Western Australia, in particular, is a region that presents many competitive opportunities. Currently, gas in the west is supplied from the northwestern shelf and transported by pipeline nearly 1,500 km to Perth in the southwest. There is considerable heavy industry in the southwest based on the area's numerous iron ore mines, gold mines, aluminum refineries, nickel smelters, and bauxite mines.

In anticipation of the opening of the competitive gas market in Australia, CalEnergy has signed an agreement with Empire Oil & Gas of Australia to earn-in to a concession in the Onshore Perth Basin of Western Australia. The concession contains the old Gingin gas field, discovered in 1965, which produced gas on a limited test basis in the early 1970s. The field is estimated to contain from 200 bcf to 470 bcf of gas, which at a minimum could supply a 250 MW plant for 20 years. Additionally, because the site is closer to the southwest than the northwestern shelf, the potential exists to provide gas to the area at competitive prices due to reduced transportation costs.

*CalEnergy is pleased with the progress of its projects in development and construction, and with the exceptional performance of its operating projects during the past year. Because of the hard work and diligence of our employees, our Company experienced record results in 1997.*

STRICT  
EVALUATION  
CRITERIA

DIVERSIFICATION  
OF REVENUE BASE  
AND FUEL SOURCES

**Disciplined  
Acquisition and  
Development  
Strategy**

EMERGING AND  
MATURE MARKET  
OPPORTUNITIES

DEREGULATED  
AND PRIVATIZED  
MARKET SELECTION

## Disciplined Acquisitions and New Project Developments

Through **disciplined acquisitions** and **new project developments**, we have broadened our position as a leading global energy services company. [ ¶ ] Fundamental to that role is our ability to **seek out, evaluate, and act** on opportunities that not only **increase our asset base** and **sources of revenue**, but also provide **fuel source diversification** and other important business synergies. [ ¶ ] By gaining valuable expertise in complementary segments of the market—as well as in **markets of various stages of maturity**—we have prepared our Company for continued success.

# Milestones and Significant Events of 1997

## *We Continued to Implement Our Strategic Plan*

CalEnergy's strategic plan is to effect growth through focused acquisitions and resource-based development. It is a strategy that has served us well and will be increasingly important to our future. The events of 1997 have proven the importance of our global reach and the necessity of our constant attention to detail and risk awareness. As we reflect on 1997 we can see that adherence to our plan has enabled CalEnergy to emerge as a leading provider of energy supply, distribution, generation, and related services.

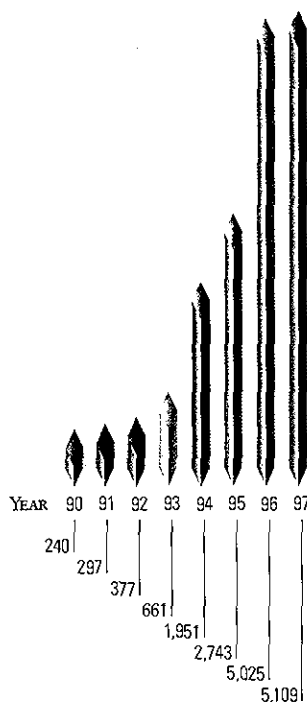
Our commitment to our strategy does not mean, however, that we are inflexible or unable to adapt to industry change. On the contrary, CalEnergy has always been an advocate for changes that benefit our customers. In the U.S., we want to bring about

increased competition to benefit customers through lower rates and better service. In the U.K., where deregulation is well underway, we are working to improve service and give customers more choices. And in the developing world, our mission is to provide electricity to people who have never experienced the full benefits that electricity provides.

Our efforts to effect change and to satisfy the needs of our customers in both mature and emerging markets are increasingly important now as world power markets embrace privatization and full-scale competition. The deregulation of the U.S. energy industry is becoming a reality, and with CalEnergy's long-term business strategies, we plan to gain our share of the new, competitive market. In those countries where we have competed for and won a share of rapidly expanding energy markets, we are demonstrating the positive effects of industry privatization. Being on the 'ground floor' in these countries provides us with a wealth of experience and expanded capabilities in generation, supply, and distribution. Our presence in these emerging economies, where electricity is in great demand, provides us with tremendous opportunities for growth.

### **Milestones of 1997**

Our focused efforts have enabled us to reach several milestones this year. To mention just a few of CalEnergy's successes in 1997, we first note that we attracted nearly 300,000 new gas customers through Northern Electric's Dual Fuel offering, a marketing program that offers customers a reduced rate on their combined electricity and gas bills. We also acquired projects in diverse locations such as Poland and Australia, completed construction on two geothermal projects in the Philippines, and maintained our commitment to excellence at each of our operational facilities.



**HISTORICAL  
GROWTH IN NET  
MEGAWATTS**

*Projects in Operation,  
Construction and Development*





*An engineer visits a stone-built electricity sub-station in Northumberland, England where Northern Electric supplies reliable electricity to its rural customers.*

### **The Integration of Northern Electric**

The most significant accomplishment of 1997, however, and the one with the most far-reaching benefits to our Company, was our assimilation of Northern Electric. Since 1990, the electricity industry in the U.K. has been privatized and restructured. Emerging victoriously from those developments is Northern Electric, which enjoys a strong performance record and reputation as a dependable energy supplier with excellent distribution assets and abilities. Through its subsidiary companies, Northern Electric delivers customers electricity and gas and offers a diverse menu of complementary energy services.

By the end of 1997, Northern Electric had attracted nearly 300,000 new gas customers and expanded its customer base by 20 percent through its Dual Fuel marketing strategy, a program that offers customers a reduced rate on their combined electricity and gas bills. Northern Electric's success in this regard is a testament to the recognition it enjoys as a supplier of quality products and superior customer service.

### **The Kiewit Transaction**

In January 1998, CalEnergy acquired Kiewit Diversified Group's ("KDG") 30 percent interest in A-rated Northern Electric, their interest in power projects in the Philippines and Indonesia, as well as the approximate 30 percent of CalEnergy stock owned by KDG.

The transaction with KDG was the next logical step to broaden our position as a leading global energy services company, and is a clear demonstration of our Company's ability to make opportune and disciplined strategic acquisitions. The transaction is beneficial to CalEnergy in many ways. During 1998 it will:

- ▶ *immediately increase revenue and earnings*
- ▶ *significantly broaden our shareholder base*
- ▶ *meet our threshold after-tax rates of return*
- ▶ *provide greater flexibility for strategic partnering as the expansion of the markets around the world continues*

### **Positioned for the Future**

A key element to our success in the global marketplace, and one that positions us for the future, is our ability to adapt to market trends and satisfy the needs of customers. It is important to note as increased competition forces the industry to become more efficient, profit margins will decrease. It is therefore critically important that we have all the pieces in place to ensure that we provide the best energy options and services at the lowest possible prices while maintaining a superior level of investment returns. CalEnergy's experience with Northern Electric during the last year has prepared us well to compete in the privatized and deregulated global markets of the future. Our hands-on experience with diverse fuel sources—such as geothermal, natural gas, and hydroelectric—and our knowledge of distribution and supply gained from our facilities in both mature and emerging markets worldwide, provides CalEnergy with an unequalled skill base.

### Significant Events of 1997

During 1997, CalEnergy realized many accomplishments. In just one year, our revenues have increased nearly 300 percent. We have assembled the finest team of employees in the industry and our management team remains focused on creating shareholder value. CalEnergy is well prepared for a leadership position as we continue to put our skills to use in the U.S., the U.K., and throughout the world.

The additional successes of our Company in 1997 will help position us for the future. They include:

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**February** *We received credit rating upgrades on our senior debt and convertible preferred securities from Standard & Poor's Corporation.*

---

**March** *CalEnergy's subsidiary, CE Electric, completed the acquisition of Northern Electric's ordinary shares.*

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**June** *CalEnergy's CE Indonesia Funding Corp. closed a \$400 million revolving credit facility (which is nonrecourse to CalEnergy) to finance the development and construction of the Company's geothermal power facilities at the Dieng, Patuha, and Bali sites in Indonesia.*

*Northern Electric received investment grade ratings from Standard & Poor's Corporation, Moody's Investors Service, and Duff & Phelps Credit Rating Co.*

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**July** *Construction was deemed complete on our Mahanagdong project, a 165 net MW geothermal facility on the island of Leyte in the Philippines. The facility sells 100 percent of its capacity to the PNOC-EDC.*

*Construction was deemed complete on the second and third units of our Malitbog project, a three-unit 216 net MW facility at the Tongonan Geothermal Reservation on the island of Leyte in the Philippines. The facility sells 100 percent of its capacity to the PNOC-EDC.*

*CalEnergy's subsidiary CalEnergy Gas (UK) Ltd. reached an agreement with the Polish Ministry of Natural Resources for exclusive gas exploration and development rights of a 13,000 square kilometer area in the Central Polish Trough of northwestern Poland. The area is situated within the geological province of the northwest European Permian Basin.*

---

**August** *CalEnergy's subsidiary CalEnergy Gas (UK) Ltd. signed an agreement with Empire Oil & Gas of Australia to earn-in to a concession in the Onshore Perth Basin of Western Australia. The concession contains the old Gingin gas field, discovered in 1965, which produced gas, in limited tests, in the early 1970s.*

*October 1998* CalEnergy signed a definitive agreement with Peter Kiewit Sons' Inc. ("PKS") and Kiewit Diversified Group Inc. ("KDG") to purchase KDG's 30 percent ownership interest in Northern Electric, various Asian project partnerships, and approximately 30 percent of CalEnergy's outstanding shares. The transaction closed on January 2, 1998 and will be accretive to earnings in 1998.

*October 1998* The Company completed an offering of 19 million shares of Common Stock at \$37 7/8 per share. The net proceeds, together with the proceeds of the offering of \$350 million 7.63 percent Senior Notes due in 2007 and general corporate funds of the Company, were used to complete the acquisition of all of KDG's interests in the Company.

Moody's Investors Service upgraded CalEnergy's senior unsecured debt rating to Ba1 and also confirmed the existing A3 rating of Northern Electric.

*October 1998* CE Electric UK Funding Company (the "Funding Company"), an indirect subsidiary of CalEnergy, closed the sale of \$125 million 6.853 percent Senior Notes due in 2004, \$237 million 6.995 percent Senior Notes due in 2007, and £200 million 7.25 percent Sterling Bonds due in 2022.

The Senior Notes were rated BBB+, Baa1 and A- by Standard & Poor's, Moody's and Duff & Phelps, respectively. The Sterling Bonds were rated AAA and Aaa by Standard & Poor's and Moody's, respectively.

The Funding Company used the net proceeds from these offerings to refinance in full the term loans incurred by its wholly owned subsidiary, CE Electric UK Holdings, which had financed the acquisition of Northern Electric.

INNOVATIVE FINANCING  
CAPABILITIES

POLITICAL RISK  
INSURANCE

Prudent  
Financial  
and Risk  
Management

U.S. DOLLAR  
CONTRACTS

ORGANIZATIONAL  
STRUCTURE AND  
DIVERSIFIED  
PROJECT PORTFOLIO

Through **prudent financial and risk management** we have positioned our Company for financial success. [ ¶ ] We are known for our ability to assemble **innovative financing packages** that enable us to reduce risk. For example, in 1992, CalEnergy completed the first ever capital markets financing secured by a pool of operating assets. [ ¶ ] Through Coso Funding Corporation, the Company raised over \$560 million. [ ¶ ] Again, in 1995, the Company raised \$475 million through the Salton Sea Funding Corporation.

## Prudent Financial and Risk Management

In our Company each project or series of related projects in one of our business units is **structured and financed separately with stand-alone, non-recourse project financing**. [ ¶ ] This 'ring-fenced' structure ensures that any hypothetical negative performance by one project is unlikely to significantly affect the Company as a whole. [ ¶ ] We constantly **add to and diversify** our project portfolio through new acquisitions and developments, and together, these initiatives have allowed our Company to achieve **impressive growth** and financial performance.

# CalEnergy

*A Force for the Future*

CalEnergy has learned its lessons well and is poised to take advantage of the opportunities of the future. We have assembled a proven management team and a dedicated, knowledgeable group of employees. We have honed our core business expertise and are able to recognize and seize opportunities, often before others know they exist. These are the attributes of success in any industry. In our industry, in particular, they are most definitely the mark of companies that will prevail in the future.

The accomplishments described within this report represent steps taken in a diligent pursuit of our strategic plan and mission—to be a leading global provider of a full range of energy services. Our strategy has served us well and will be increasingly important to our future. Events of 1997 have proven the importance of our global reach and the necessity of our constant attention to detail and risk awareness.

The recent unprecedented Asian currency problems have put great strain on many of the Asian economies and confusion in the world's capital markets. It is during these inevitable times

of economic setbacks that our discipline and attention to detail offers rewards. We have specifically structured our Company with a diversified project portfolio to avoid undue dependence on the economy of one country or region. CalEnergy is truly a global organization—our Company as a whole is much greater than the sum of our individual parts. We will continue to keep a watchful eye on developments in Asia and will work closely with our partners during these trying times.

In conclusion, the future of our industry holds more opportunity than at any time in history. Deregulation and privatization of the electricity sector worldwide is constantly increasing the size of our marketplace. With CalEnergy's diverse fuel operating expertise, natural gas and geothermal resource development capabilities, and electricity and gas distribution and supply expertise—combined with our unparalleled information technology resources—we have the tools in place to capitalize on these many opportunities and truly become a force for the future.

**CalEnergy's mission: to become a leading global provider of a full range of energy services.**



# CalEnergy Company, Inc.

## 1997 Financial Report

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## Financial Summary

Over the last three years ended December 31, 1997, CalEnergy Company, Inc. ("CalEnergy" or the "Company") has experienced significant growth. Revenues have risen at a compound annual rate of 130% from approximately \$186 million in 1994 to approximately \$2,271 million in 1997 and net income available to common stockholders excluding non-recurring and extraordinary items has risen at a compound annual rate of 60% from approximately \$33.8 million in 1994 to approximately \$138.8 million in 1997. This significant growth has been achieved through: (i) acquisitions that complement and diversify the Company's existing business, broaden the geographic locations of its assets and enhance its competitive capabilities; (ii) enhancement of the financial and technical performance of existing and acquired projects; and (iii) development and construction of new plants.

On September 11, 1997, the Company signed a definitive agreement with Kiewit Diversified Group ("KDG"), a wholly owned subsidiary of Peter Kiewit Sons', Inc. ("PKS"), for the Company to purchase KDG's ownership interest in various project partnerships and CalEnergy common shares (the "KDG Acquisition"). Accordingly, common stock and options subject to redemption have been reclassified in the consolidated balance sheet.

KDG's ownership interest in CalEnergy comprised 20,231,065 shares of common stock (assuming exercise by KDG of one million options to purchase CalEnergy shares), the 30% interest in Northern Electric plc ("Northern"), as well as the following minority project interests: Mahanagdong (45%), Casecnan (35%), Dieng (47%), Patuha (44%) and Bali (30%) and other interests in international development stage projects.

CalEnergy paid approximately \$1,159 million for the KDG Acquisition and final closing of the transaction occurred in January 1998. CalEnergy funded this acquisition with available cash and the net proceeds of the equity and senior note offerings completed in October 1997.

On December 24, 1996, CE Electric plc ("CE Electric"), which in 1997 was 70% owned indirectly by the Company and 30% owned indirectly by PKS, acquired majority ownership of the outstanding ordinary share capital of Northern pursuant to a tender offer (the "Northern Tender Offer") commenced in the United Kingdom on November 5, 1996. As of March 18, 1997, CE Electric effectively owned 100% of Northern's ordinary shares.



In the last three years, the Company has consummated three other significant acquisitions, in addition to the acquisition of Northern. In January 1995, the Company acquired Magma Power Company ("Magma"), a publicly-traded United States independent power producer with 228 megawatts ("MW") of aggregate net operating capacity and 154 MW of aggregate net ownership capacity, for approximately \$958 million. In April 1996, the Company completed the buy-out for approximately \$70 million of its partner's interests ("Partnership Interest") in four electric generating plants in Southern California, resulting in sole ownership of the Imperial Valley Project. In August 1996, the Company acquired Falcon Seaboard Resources, Inc. ("Falcon Seaboard") for approximately \$226 million, thereby acquiring significant ownership in 520 MW of natural gas-fired electric production facilities located in New York, Texas and Pennsylvania and a related gas transmission pipeline.

The Company has substantially completed constructing the Dieng Unit I, 55 net MW geothermal project in Indonesia, which is the first unit of 400 MW under contract at Dieng. In 1997, the Company financed and commenced construction of two other projects; the Dieng Unit II 80 MW project as well as the Patuha Unit I 80 MW project, which is the first unit of 400 MW under contract at Patuha. Additionally, the Company has conducted infrastructure construction and drilling activities for the 400 MW Bali project. Although the Company intends to enforce its contractual rights with the Indonesian government, the ultimate outcome of the current uncertain situation in Indonesia with respect to the possible abrogation by the Indonesian government of the Dieng, Patuha and Bali contracts adds significant risk to the completion of those projects and resulted in the Company recording an asset impairment charge in the fourth quarter of 1997. This \$87 million charge includes all reasonably estimated asset valuation impairments associated with the Company's assets in Indonesia and gives effect to the political risk insurance on such investment.

# Selected Financial Data

Dollars in Thousands, Except Per Share Amounts

	Year Ended December 31,				
	1997	1996 <sup>1</sup>	1995 <sup>2</sup>	1994	1993
<b>Income Statement Data:</b>					
Operating revenue	\$ 2,166,338	\$ 518,934	\$ 335,630	\$ 154,562	\$ 132,059
Total revenue	2,270,911	576,195	398,723	185,854	149,253
Expenses	2,074,051	435,791	301,672	130,018	87,995
Income before provision for income taxes	196,860 <sup>3</sup>	140,404	97,051	55,836	61,258
Minority interest	45,993	6,122	3,005	—	—
Income before change in accounting principle and extraordinary item	51,823 <sup>3</sup>	92,461	63,415	38,834	43,074
Cumulative effect of change in accounting principle	—	—	—	—	4,100
Extraordinary item	(135,850)	—	—	(2,007)	—
Net income (loss)	(84,027) <sup>3</sup>	92,461	63,415	36,827	47,174
Prefetted dividends	—	—	1,080	5,010	4,630
Net income (loss) available to common stockholders	(84,027) <sup>3</sup>	92,461	62,335	31,817	42,544
Income per share before change in accounting principle and extraordinary item	0.77 <sup>3</sup>	1.69	1.32	1.02	1.08
Cumulative effect of change in accounting principle per share	—	—	—	—	0.12
Extraordinary item per share	(2.02)	—	—	(0.06)	—
Net income (loss) per share	(1.25) <sup>3</sup>	1.69	1.32	0.96	1.20
<b>Balance Sheet Data:</b>					
Total assets	7,487,626	5,630,156	2,654,038	1,131,145	715,984
Total liabilities	5,282,162	4,181,052	2,084,474	867,703	425,393
Company-obligated mandatorily redeemable convertible prefetted securities of subsidiary trusts	553,930	103,930	—	—	—
Preferred securities of subsidiary	56,181	136,065	—	—	—
Minority interest	134,454	299,252	—	—	—
Redeemable preferred stock	—	—	—	63,600	58,800
Stockholders' equity	765,326	880,790	543,532	179,991	211,503

<sup>1</sup> Reflects the acquisitions of Northern, Falcon Seaboard and the Partnership Interest owned for a portion of the year. See Note 4 to the financial statements.

<sup>2</sup> Reflects the acquisition of Magma owned for a portion of the year.

<sup>3</sup> Includes the \$87,000, \$1.29 per share, non-recurring asset impairment charge.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

*Dollars, Pounds and Shares in Thousands, Except Per Share Amounts*

The following is management's discussion and analysis of certain significant factors which have affected the Company's financial condition and results of operations during the periods included in the accompanying statements of operations. The Company's actual results in the future could differ significantly from the Company's historical results.

## *Acquisitions*

On December 24, 1996, CE Electric plc ("CE Electric"), which in 1997 was 70% owned indirectly by the Company and 30% owned indirectly by Peter Kiewit Sons', Inc. ("PKS"), acquired majority ownership of the outstanding ordinary share capital of Northern Electric plc ("Northern") pursuant to a tender offer (the "Northern Tender Offer") commenced in the United Kingdom on November 5, 1996. As of March 18, 1997, CE Electric effectively owned 100% of Northern's ordinary shares.

In the last three years, the Company has consummated three other significant acquisitions, in addition to the acquisition of Northern. In January 1995, the Company acquired Magma Power Company ("Magma"), a publicly-traded United States independent power producer with 228 megawatts ("MW") of aggregate net operating capacity and 154 MW of aggregate net ownership capacity, for approximately \$958,000. In April 1996, the Company completed the buy-out for approximately \$70,000 of its partner's interests ("Partnership Interest") in four electric generating plants in Southern California, resulting in sole ownership of the Imperial

Valley Project. In August 1996, the Company acquired Falcon Seaboard Resources, Inc. ("Falcon Seaboard") for approximately \$226,000, thereby acquiring significant ownership in 520 MW of natural gas-fired electric production facilities located in New York, Texas and Pennsylvania and a related gas transmission pipeline.

## *Power Generation Projects*

For purposes of consistency in financial presentation, plant capacity factors for Navy I, Navy II, and BLM plants (collectively the "Coso Project"), are based upon a nominal capacity amount of 80 net MW for each plant. Plant capacity factors for Vulcan, Hoch (Del Ranch), Elmote, Leathers plants (collectively the "Partnership Project"), are based on nominal capacity amounts of 34, 38, 38, and 38 net MW, respectively, and for Salton Sea I, Salton Sea II, Salton Sea III and Salton Sea IV plants (collectively the "Salton Sea Project"), are based on nominal capacity amounts of 10, 20, 49.8 and 39.6 net MW, respectively (the Partnership Project and the Salton Sea Project are collectively referred to as the "Imperial Valley Project"). Plant capacity factors for Saranac, Power Resources, NorCon and Yuma plants (collectively the "Gas Plants") are based on capacity amounts of 240, 200, 80 and 50 net MW, respectively. Each plant possesses an operating margin which allows for production in excess of the amount listed above. Utilization of this operating margin is based upon a variety of factors and can be expected to vary throughout the year under normal operating conditions.

*See Note 5 to the financial statements for a discussion of the Company's significant operating contracts.*

**Results of Operations Three Years  
Ended December 31, 1997,  
1996 and 1995**

Operating revenues increased to \$2,166,338 in the year ended December 31, 1997, from \$518,934 in the year ended December 31, 1996, a 317.5% increase. This growth was primarily due to the acquisitions of Northern, Falcon Seaboard, and the Partnership Interest as well as the commencement of earnings at Salton Sea IV, Upper Mahiao and Malitbog.

The increase in operating revenues in 1996 to \$518,934 from \$335,630 in 1995 was primarily due to the acquisitions of the Partnership Interest, Falcon Seaboard and Northern, the deemed completion and commencement of receipt of revenues from Upper Mahiao and Unit I of the Malitbog Project in the Philippines, the completion and commencement of commercial operation of Salton Sea IV and an increase in the Coso Project's electricity revenues.

The following data represents the supply and distribution operations at Northern:

	1997	1996	1995
Supply (GWh)	14,389	14,185	14,253
Distribution (GWh)	15,714	15,656	15,260
Gas Therms Supply (in thousands)	74.5	50.0	35.3

The increase in units supplied and distributed in 1997 from 1996 primarily reflects increased activity in the local economy. The increase in therms supplied in 1997 from 1996 reflects the increased volume as the gas business in the U.K. begins to open up to competition as a result of regulatory changes.

The following operating data represents the aggregate capacity and electricity production of the domestic geothermal projects:

	1997	1996	1995
Overall capacity factor	101.4%	104.4%	104.8%
kWh produced (in thousands)	4,507,500	4,502,200	4,296,010
Capacity NMW (average)	507.4	491.0*	467.8

\* Weighted average for the commencement of operations at the Salton Sea IV in 1996.

The capacity factor was 100.4% in the fourth quarter of 1997 compared to 102.6%, 99.6% and 103.1% for the third, second and first quarters of 1997, respectively. The capacity factor decreased in 1997 from 1996 due to marginally decreasing production at the Coso Project and a scheduled turbine overhaul at BLM in April 1997.

The following operating data represents the aggregate capacity and electricity production of the Gas Plants:

	1997	1996	1995
Overall capacity factor	84.3%	84.2%	88.8%
kWh produced (in thousands)	4,211,030	4,216,800	4,433,900
Installed capacity NMW	570	570	570

The capacity factor of the Gas Plants reflects the effect of certain contractual curtailments. The capacity factors adjusted for these contractual curtailments are 95.7%, 93.2% and 96.8% for 1997, 1996 and 1995, respectively.

Electric sale price per kWh for the Coso Project, Partnership Project and Salton Sea Project varies seasonally in accordance with the rate schedule referenced in the SO4 agreements and power purchase agreements. The Coso Project's, Partnership Project's and Salton Sea Project's average electricity prices per kWh received in 1997, 1996 and 1995 were comprised of (in cents):

Coso Project	Energy	Capacity & Bonus	Total
Average fiscal 1997	12.56	1.91	14.47
Average fiscal 1996	12.61	1.82	14.43
Average fiscal 1995	11.81	1.82	13.63
Partnership Project	Energy	Capacity & Bonus	Total
Average fiscal 1997	10.96	2.18	13.14
Average fiscal 1996	10.02	2.12	12.14
Average fiscal 1995	11.14	2.10	13.24
Salton Sea Project	Energy	Capacity & Bonus	Total
Average fiscal 1997	8.66	1.97	10.63
Average fiscal 1996	8.84	2.29	11.13
Average fiscal 1995	9.50	2.33	11.83

Interest and other income increased in 1997 to \$104,573 from \$57,261 in 1996, an 82.6% increase. This increase was due primarily to interest earned by Northern, equity earnings from Saranac and Mahanagdong, and increased interest income on the proceeds of the equity and senior note offerings in October 1997. Interest and other income decreased in 1996 to \$57,261 from \$63,093 in 1995.

Overall, the Company's expenses increased in 1997 due to the full year of operations of Northern, Falcon Seaboard, Partnership Interest, Salton Sea IV Project, Upper Mahiao Project and Unit I of the Malitbog Project and the deemed completion of Units II and III of the Malitbog Project in July 1997.

Cost of sales increased to \$1,055,195 in 1997 from \$31,840 in 1996. This increase is a result of reflecting a full year of Northern's operations. Cost of sales represents Northern's costs of electricity and appliances during the period of the Company's controlling interest since December 24, 1996.

Operating expense increased to \$345,833 in 1997 from \$132,655 in 1996, an increase of 160.7%. This increase is a result of the acquisitions of Northern, Falcon Seaboard and the Partnership Interest as well as the commencement of receipt of revenue at Salton Sea IV, Upper Mahiao and Malitbog. Operating expense increased to \$132,655 in 1996 from \$103,602 in 1995, an increase of 28.0%. The increase is a result of the Falcon Seaboard and the Partnership Interest acquisitions, and the commencement of operations of the Salton Sea IV Project.

General and administration costs increased to \$52,705 in 1997 from \$21,451 in 1996, an increase of 145.7%. This increase is primarily a result of the addition of Northern. General and administration costs decreased to \$21,451 in 1996 from \$23,376 in 1995, a decrease of 8.2%. This decrease is a result of the Company's continued efforts to reduce costs and reflects the elimination of redundant functions subsequent to the acquisition of Magma.

Depreciation and amortization increased to \$276,041 in 1997 from \$118,586 in 1996, an increase of 132.8%. This increase is a result of the acquisitions of Northern, Falcon Seaboard and the Partnership Interest as well as the commencement of the receipt of revenue at Salton Sea IV, Upper Mahiao and Malitbog. Depreciation and amortization increased in 1996 to \$118,586 from \$72,249 in 1995, a 64.1% increase. This increase is primarily due to the Magma, Partnership Interest and Falcon Seaboard acquisitions, and the commencement of the receipt of revenue at Salton Sea IV, Upper Mahiao and Malitbog.

Loss on equity investment in the Casecanan Project reflects the Company's share of interest expense in excess of capitalized interest and interest income at the Casecanan Project, which is currently in construction.

Interest expense, less amounts capitalized, increased in 1997 to \$251,305 from \$126,038 in 1996, a 99.4% increase, and increased to \$126,038 in 1996 from \$102,083 in 1995, a 23.5% increase. Higher interest expense is primarily due to a larger portfolio of facilities and their associated debt partially offset by the increase in capitalized interest on the Company's international and domestic projects.

The non-recurring charge of \$87,000 represents an asset valuation impairment under Financial Accounting Standard No. 121, "Accounting for the Impairment of Long-Lived Assets", relating to CalEnergy's assets in Indonesia. The charge includes all reasonably estimated asset valuation impairments associated with the Company's assets in Indonesia and gives effect to the

political risk insurance on such investments. The estimate assumes there will be no tax benefits associated with the asset valuation impairment.

The provision for income taxes increased to \$99,044 in 1997 from \$41,821 in 1996 and \$30,631 in 1995. After adjusting for the non-recurring charge for asset valuation impairment and the dividends on convertible preferred securities, the effective tax rate was 38.0%, 30.8%, and 31.6% in 1997, 1996, and 1995, respectively. The increase from 1996 to 1997 is due primarily to larger energy tax credits and depletion deductions in 1996.

Minority interest increased to \$45,993 in 1997 from \$6,122 in 1996, an increase of 651.3%. Minority interest consists of dividends on convertible preferred securities of subsidiary trusts and the Company's partial ownership in Northern. This increase is a result of issuance of the \$180,000 of Trust II Securities in February 1997 and \$270,000 of Trust III Securities in August 1997 and a full year of operations from Northern. Minority interest in 1995 reflects the Company's partial ownership in Magma for the period from January 10, 1995 to February 24, 1995.

Income before extraordinary item was \$51,823 or \$0.77 per common share in 1997 compared to \$92,461 or \$1.69 per common share in 1996 and \$62,335 or \$1.32 per common share in 1995. Excluding the \$87,000, \$1.29 per share, non-recurring charge, income before extraordinary item would have been \$138,823 in 1997.

On July 31, 1997, the Finance Act in the United Kingdom was passed by Parliament and included the introduction of a one time so-called "windfall tax" equal to 23% of the difference between the price paid for Northern upon privatization and the Labour government's assessed "value" of Northern as calculated by reference to a formula set forth in the July budget. This amounted to \$135,850, net of minority interest, which was recorded as an extraordinary item. The first installment was paid on December 1, 1997 and the second installment is payable on December 1, 1998.

#### *Liquidity and Capital Resources*

Cash and short-term investments were \$1,446,620 at December 31, 1997 as compared to \$429,421 at December 31, 1996. In addition, the Company's share of joint venture cash and investments retained in project control accounts was \$6,072 and \$47,764 at December 31, 1997 and 1996, respectively. Distributions out of the project control accounts are made monthly to the Company for operation and maintenance and capital costs and semiannually to each Coso Project partner for profit sharing under a prescribed calculation subject to mutual agreement by the partners. In addition, the Company recorded separately restricted cash of \$223,636 and \$106,968 at December 31, 1997 and 1996, respectively. The restricted cash balances are comprised primarily of amounts deposited in restricted accounts from which the Company will fund construction of Dieng Unit II and Patuha Unit I; the Power Resources Project, the Upper Mahiao Project and the Malitbog Project cash reserves for the debt service reserve funds; and the Coso Project royalty payment.

The Company repurchased 1,622 common shares during 1997 for the aggregate amount of \$55,505. The Company repurchased 472 shares of common stock in 1996 at an aggregate amount of \$12,008. As of December 31, 1997 the Company held 1,658 shares of treasury stock at a cost of \$56,525 to provide shares for issuance under the Company's employee stock option and share purchase plan and other outstanding convertible securities. The repurchase plan minimizes the dilutive effect of the additional shares issued under these plans.

On September 11, 1997, the Company signed a definitive agreement with Kiewit Diversified Group ("KDG"), a wholly owned subsidiary of PKS, for the Company to purchase KDG's ownership interest in various project partnerships and CalEnergy common shares (the "KDG Acquisition").

KDG's ownership interest in CalEnergy comprised approximately 20,231 shares of common stock (assuming exercise by KDG of one million options to purchase CalEnergy shares), the 30% interest in Northern Electric, as well as the following minority project interests: Mahanagdong (45%), Casecan (35%), Dieng (47%), Patuha (44%) and Bali (30%) and other interests in international development projects.

CalEnergy paid \$1,159,215 for the KDG Acquisition and final closing of the transaction occurred in January 1998. CalEnergy funded this acquisition with available cash and the proceeds of the equity and senior note offerings completed in October 1997.

On December 15, 1997, CE Electric UK Funding Company, an indirect subsidiary of the Company (the "Funding Company"), issued \$125,000 of 6.853% senior notes due 2004, and \$237,000 of 6.995% senior notes due 2007 (collectively, the "CE Electric UK Funding Company Senior Notes"), and £200,000 of 7.25% Sterling Bonds due 2022.

On November 26, 1997, the Company amended and increased its \$100,000 revolving credit facility to \$400,000. The facility is unsecured and is available to fund working capital requirements and finance future business expansion opportunities.

On October 17, 1997, the Company completed the public offering of 17.1 million shares of its common stock ("Common Stock") at \$37 7/8 per share (the "Public Offering"). In addition, 2 million shares of Common Stock were purchased from CalEnergy in a direct sale by a trust affiliated with Walter Scott, Jr., the Chairman and Chief Executive Officer of PKS (the "Direct Sale"), contemporaneously with the closing of the Public Offering.

On October 28, 1997, the Company completed the sale of \$350,000 aggregate principal amount of its 7.63% Senior Notes due 2007 (the "Senior Note Offering").

On August 12, 1997, a subsidiary of the Company completed a private placement (with certain shelf registration rights) of \$225,000 aggregate amount of 6 1/2% Trust Convertible Preferred Securities (the "6 1/2% Trust Securities"). In addition, an option to purchase an additional 900 of the 6 1/2% Trust Securities, or \$45,000 aggregate amount, was exercised by the initial purchasers to cover overallocments in connection with the placement. Each 6 1/2% Trust Security has a liquidation preference of fifty dollars and is convertible at any time at the option of the holder into 1.047 shares of Company Common Stock (equivalent to a conversion price of \$47.75 per common share) subject to adjustments in certain circumstances.

On August 5, 1997, the Company and certain affiliated capital funding trusts filed with the Securities and Exchange Commission a shelf registration statement covering up to \$1,500,000 of common stock, preferred stock and debt securities which may be sold from time to time for various purposes. The Company completed the Public Offering and the Senior Note Offering under the shelf registration statement.

On February 26, 1997, a subsidiary of the Company completed a private placement (with certain shelf registration rights) of \$150,000 aggregate amount of 6 1/4% Trust Convertible Preferred Securities ("Trust Securities"). In addition, an option to purchase an additional 600 Trust Securities, or \$30,000 aggregate amount, was exercised by the initial purchasers to cover over-allotments in connection with the placement. Each Trust Security has a liquidation preference of fifty dollars and is convertible at any time at the option of the holder into 1.1655 shares of Company Common Stock (equivalent to a conversion price of \$42.90 per common share) subject to adjustments in certain circumstances.



In November 1995, the Company closed the financing and commenced construction of the Casecnan Project, a combined irrigation and 150 net MW hydroelectric power generation project (the "Casecnan Project") located in the central part of the island of Luzon in the Republic of the Philippines.

CE Casecnan Water and Energy Company, Inc., a Philippine Corporation ("CE Casecnan") which is approximately 70% indirectly owned by the Company (after the KDG Acquisition), is developing the Casecnan Project. CE Casecnan financed a portion of the costs of the Casecnan Project through the issuance of \$125,000 of its 11.45% Senior Secured Series A Notes due 2005 and \$171,500 of its 11.95% Senior Secured Series B Bonds due 2010 and \$75,000 of its Secured Floating Rate Notes due 2002, pursuant to an indenture dated as of November 27, 1995, as amended to date.

The Casecnan Project was being constructed pursuant to a fixed-price, date-certain, turnkey construction contract (the "Hanbo Contract") on a joint and several basis by Hanbo Corporation ("Hanbo") and Hanbo Engineering and Construction Co., Ltd. ("HECC"), both of which are South Korean corporations. As of May 7, 1997, CE Casecnan terminated the Hanbo Contract due to defaults by Hanbo and HECC including the insolvency of each such company. On May 7, 1997, CE Casecnan entered into a new turnkey engineering, procurement and construction contract to complete the construction of the Casecnan Project (the "Replacement Contract"). The work under the Replacement Contract is

being conducted by a consortium consisting of Cooperativa Muratori Cementisti CMC di Ravenna and Impresa Pizzarottie & C. Spa, working together with Siemens A.G., Sulzer Hydro Ltd., Black & Veatch and Colenco Power Engineering Ltd. (collectively, the "Replacement Contractor").

In connection with the Hanbo Contract termination, CE Casecnan tendered a certificate of drawing to Korea First Bank ("KFB") on May 7, 1997, under the irrevocable standby letter of credit issued by KFB as security under the Hanbo Contract to pay for certain transition costs and other presently ascertainable damages under the Hanbo Contract. As a result of KFB's wrongful dishonor of the draw request, CE Casecnan filed an action in New York State Court. That Court granted CE Casecnan's request for a temporary restraining order requiring KFB to deposit \$79,329, the amount of the requested draw, in an interest bearing account with an independent financial institution in the United States. KFB appealed this order, but the appellate court denied KFB's appeal and on May 19, 1997, KFB transferred funds in the amount of \$79,329 to a segregated New York bank account pursuant to the Court order.

On August 6, 1997, CE Casecnan announced that it had issued a notice to proceed to the Replacement Contractor. The Replacement Contractor thereafter fully mobilized and commenced engineering, procurement and construction work on the Casecnan Project.

On August 27, 1997, CE Casecnan announced that it had received a favorable summary judgment ruling in New York State Court against KFB. The judgment, which has been appealed by the bank, requires KFB to honor the \$79,329 drawing by CE Casecnan on a \$117,850 irrevocable standby letter of credit.

On September 29, 1997, CE Casecnan tendered a second certificate of drawing for \$10,828 to KFB and on December 30, 1997 CE Casecnan tendered a third certificate of drawing for \$2,920 to KFB. KFB also wrongfully dishonored these draws, but pursuant to a stipulation agreed to deposit the draw amounts in an interest bearing account with the same independent financial institution in the United States pending resolution of the appeal regarding the first draw and agreed to expedite the appeal.

The receipt of the letter of credit funds from KFB remains essential and CE Casecnan will continue to press KFB to honor its clear obligations under the letter of credit and to pursue Hanbo and KFB for any additional damages arising out of their actions to date. If KFB were to fail to honor its obligations under the Casecnan letter of credit, such action could have a material adverse effect on the Casecnan Project and CE Casecnan.

On September 2, 1997, Hanbo and HECC filed a Request for Arbitration before the International Chamber of Commerce ("ICC"). The Request for Arbitration asserts various claims by Hanbo and HECC against CE Casecnan relating to the terminated Hanbo Contract and seeking damages. On October 10, 1997, CE Casecnan served its answer and defenses in response to the Request for Arbitration as well as counterclaims against Hanbo and HECC for breaches of the Hanbo Contract. The arbitration proceedings before the ICC are ongoing

and CE Casecnan intends to pursue vigorously its claims against Hanbo, HECC and KFB in the proceedings described above.

In June 1997, the Company's indirect special-purpose subsidiary, CE Indonesia Funding Corp., entered into a \$400,000 revolving credit facility (which is nonrecourse to the Company) to finance the development and construction of the Company's geothermal power facilities in Indonesia.

On September 20, 1997, a Presidential Decree (the "Decree") was issued in Indonesia, providing for government action to the effect that, in order to address certain recent fluctuations in the value of the Indonesian currency, the start-up dates for a number of private power projects would be: (i) continued according to their initial schedule (because construction was underway); (ii) postponed as to their start-up dates (because they are not yet in construction) until economic conditions have recovered; or (iii) reviewed with a view to being continued, postponed or rescheduled, depending on the status of those projects. In the Decree, Dieng Units 1, 2 and 3 are approved to continue according to their initial schedule; Patuha Unit 1 and Bali Units 1 and 2 are to receive further review to determine whether or not they should be continued in accordance with their initial schedule; and Bali Units 3 and 4, Patuha Units 2, 3 and 4 and Dieng Unit 4 are to be postponed for an unspecified period. In this regard, the Company notes that its contracts and government undertakings for the Dieng, Patuha and Bali projects do not by their terms permit such categorization or delays by the government and that the Company has obtained political risk insurance coverage for its Dieng and Patuha projects. Moreover, the Company intends to continue to take actions to attempt to require the government

of Indonesia to honor its contractual obligations; however, subsequent actions by the Government of Indonesia and continued economic problems in Indonesia have created further uncertainty as to whether the contracts for such projects will be abrogated by the Indonesian government and accordingly have created significant risks to the completion of these projects. As a result, the Company recorded a SFAS 121 asset valuation impairment charge of \$87,000 in the fourth quarter of 1997. This charge includes all reasonably estimated asset valuation impairments associated with the Company's assets in Indonesia and gives effect to the political risk insurance on such investments.

On December 2, 1994, a subsidiary of the Company, Himpurna California Energy Ltd. ("HCE") executed a joint operation contract (the "Dieng JOC") for the development of the geothermal steam field and geothermal power facilities at the Dieng geothermal field, located in Central Java (the "Dieng Project") with Perusahaan Pertambangan Minyak Dan Gas Bumi Negara ("Pertamina"), the Indonesian national oil company, and executed a "take-or-pay" energy sales contract (the "Dieng ESC") with both Pertamina and PT. PLN (Persero) ("PLN"), the Indonesian national electric utility. HCE was formed pursuant to a joint development agreement with PT. Himpurna Enersindo Abadi ("P.T. HEA"), its Indonesian partner, which is a subsidiary of Himpurna, whereby the Company and P.T. HEA have agreed to work together on an exclusive basis to develop the Dieng Project (the "Dieng Joint Venture"). Subsequent to the January 1998 KDG acquisition, the Dieng Joint Venture is

structured with subsidiaries of the Company holding an approximate 94% interest (including certain assignments of dividend rights representing an economic interest of 4%), and P.T. HEA holding a 6% interest in the Dieng Project. Financial closing and first disbursement of construction loan funds occurred on October 3, 1996. Construction of Dieng Unit I is expected to be completed in March 1998.

Pursuant to the Dieng JOC and ESC, Pertamina has granted to HCE the geothermal field and the wells and other facilities presently located thereon and HCE may build, own and operate power production units with an aggregate capacity of up to 400 MW. HCE will accept the field operation responsibility for developing and supplying the geothermal steam and fluids required to operate the plant. The Dieng JOC is structured as a build own operate transfer agreement and will expire (subject to extension by mutual agreement) on the date which is the later of (i) 42 years following effectiveness of the Dieng JOC and (ii) 30 years following the date of commencement of commercial generation of the final unit. Upon the expiration of the proposed Dieng JOC, all facilities will be transferred to Pertamina at no cost.

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HCE began well testing in the fourth quarter of 1995 and issued a notice to proceed for the construction and supply of an initial 55 net MW unit ("Dieng Unit I") in the first quarter of 1996. PT Kiewit/Holt Indonesia, a consortium including Kiewit Construction Group, Inc., a subsidiary of PKS ("KCG"), is constructing Dieng Unit I pursuant to a fixed price, date certain, turnkey construction contract ("Construction Contract"). Affiliates of KCG are providing the engineered supply with respect to Dieng Unit I pursuant to a fixed price, date certain, turnkey supply contract ("Supply Contract"). The Construction Contract and Supply Contract are sometimes referred to herein as the "Dieng EPC" and KCG and their affiliates party to the Construction Contract and Supply Contract are sometimes referred to herein, collectively, as the "Construction Consortium." The obligations of the Construction Consortium under the Construction and Supply Contracts are supported by a guaranty of KCG. KCG is the lead member of the Construction Consortium, with a 60% interest. HCE will be responsible for operating and managing the Dieng Project.

In the fourth quarter of 1997, HCE issued a notice to proceed for the construction and supply of the Dieng Unit II 80 net MW project. The same construction consortium as described above for Dieng Unit I has contracted to construct Dieng Unit II under similar terms. The Company has contributed the necessary equity for the completion of Dieng Unit II and the construction loan of \$109,000 was arranged under the June 1997 CE Indonesia Funding Corp. facility. However, pending resolution of the current uncertainties associated with Indonesia, construction activities on this project have been significantly reduced.

Patuha Power, Ltd. ("Patuha Power") is developing a geothermal power plant in the Patuha geothermal field in Java, Indonesia (the "Patuha Project"). On December 2, 1994, Patuha Power executed both a joint operation contract and an energy sales contract, each of which contains terms substantially similar to those described above for the Dieng Project. Patuha Power began well testing and exploration in the fourth quarter of 1995 and in the third quarter of 1997, issued a notice to proceed for the construction and supply of the Patuha Unit I 80 net MW project. The same construction consortium as described above for Dieng Unit I has contracted to construct Patuha Unit I under similar terms. The Company has contributed the necessary equity for the completion of Patuha Unit I and the construction loan of \$150,000 was arranged under the June 1997 CE Indonesia Funding Corp. facility. However, pending resolution of the current uncertainties associated with Indonesia, construction activities on this project have been significantly reduced.

The Company and PT Panutan Group, an Indonesian consortium of energy, oil, gas and mining companies, have formed a joint venture to pursue the development of geothermal resources in Bali (the "Bali Project"). The PT Panutan Group is entitled to contribute up to 40% of the total equity and obtain up to 40% of the net profit of the Bali Project. The project company developing the Bali Project, Bali Energy Ltd. ("Bali Energy"), has executed both a joint operation contract and an energy sales contract with terms similar to those at Dieng and Patuha. However, pending resolution of the current uncertainties associated with Indonesia, infrastructure construction and drilling activities on this project have been significantly reduced.

The Company developed and owns the rights to a proprietary process for the extraction of minerals from elements in solution in the geothermal brine and fluids utilized at its Imperial Valley plants (the "Salton Sea Extraction Project") as well as the production of power to be used in the extraction process. The initial phase of the project would require delivery of 49 net MW of power. A pilot plant has successfully produced commercial quality zinc at the Company's Imperial Valley Project. Zinc is primarily used in galvanizing steel for use in the automobile industry. The Company intends to sequentially develop manganese, silver, gold, lead, boron, lithium and other products as it further develops the extraction technology. The Company is also investigating producing silica from the solids precipitated out of the geothermal power process. Silica is used as a filler for such products as paint, plastics and high temperature cement. If successfully developed, the mineral extraction process will provide an environmentally responsible and low cost minerals recovery methodology.

Subsidiaries of Magma, a subsidiary of the Company, sought new long-term final SO<sub>4</sub> power purchase agreements in the Salton Sea area through the bidding process adopted by the California Public Utilities Commission ("CPUC") under its 1992 Biennial Resource Plan Update ("BRPU"). In its BRPU, the CPUC cited the need for an additional 9,600 MW of power production through 1999 among California's three investor-owned utilities, Southern California Edison Company ("Edison"), San Diego Gas and Electric

("SDG&E") and Pacific Gas and Electric Company. Of this amount, 275 MW was set aside for bidding by independent power producers (such as Magma) utilizing renewable resources. Pursuant to an order of the CPUC dated June 22, 1994 (confirmed on December 21, 1994), Magma was awarded 163 net MW for sale to Edison and SDG&E, with in-service dates in 1997 and 1998. On February 23, 1995 the Federal Energy Regulatory Commission ("FERC") issued an order finding that the CPUC's BRPU program violated the Public Utilities Regulatory Policies Act ("PURPA") and FERC's implementing regulations and recommended negotiated settlements. In response, the CPUC issued an Assigned Commissioners Ruling encouraging settlements between the final winning bidders and the utilities. The utilities are expected to continue to challenge the BRPU and, in light of the regulatory uncertainty, there can be no assurance that power sales contracts will be executed or that any such projects will be completed. In light of these developments, the Company agreed to execute an agreement with Edison on March 16, 1995, providing that in certain circumstances it would withdraw its Edison BRPU bid in consideration for the payment of certain sums. In December 1996, the Company entered into a confidential cash buyout agreement with SDG&E. These agreements are subject to CPUC approval.

Within the United Kingdom there was continued investment to extend and improve the electricity distribution network. Expenditures in the year were approximately \$102,000 although customers directly contributed approximately \$33,000 to the additional costs incurred in expanding the system to meet their specific requirements.

The Company is actively seeking to develop, construct, own and operate new energy projects, both domestically and internationally, the completion of any of which is subject to substantial risk. Development can require the Company to expend significant sums for preliminary engineering, permitting, fuel supply, resource exploration, legal and other expenses in preparation for competitive bids which the Company may not win or before it can be determined whether a project is feasible, economically attractive or capable of being financed. Successful development and construction is contingent upon, among other things, negotiation on terms satisfactory to the Company of engineering, construction, fuel supply and power sales contracts with other project participants, receipt of required governmental permits and consents and timely implementation of construction. There can be no assurance that development efforts on any particular project, or the Company's development efforts generally, will be successful.

The Company has various projects under construction outside the United States, a number of projects under award outside the United States and a number of operating projects doing business outside the United States. The operation, financing, construction and development of projects outside the United States entail significant political and financial risks (including, without limitation, uncertainties associated with first time privatization efforts in the countries involved, currency exchange rate fluctuations, currency repatriation restrictions, changes in law or regulation, changes in government policy, political instability, civil unrest, contract abrogation and expropriation) and other risk/structuring issues that have the potential to cause substantial delays or material impairment of the value of the project being developed, which the Company may not be fully capable of insuring against. The uncertainty of the legal environment in certain foreign countries in which the Company is developing and may develop or acquire projects could make it more difficult for the Company to enforce its rights under agreements relating to such projects. In addition, the laws and regulations of certain countries may limit the ability of the Company to hold a majority interest in some of the projects that it may develop or acquire. The Company's international projects may, in certain cases, be delayed, suspended or terminated by the applicable government or may be subject to risks of contract abrogation or other uncertainties relating to changes in government policy or personnel or changes

in general economic conditions affecting the country. Projects in operation, construction and development are subject to a number of uncertainties, more specifically described in the Company's Form 8-K dated March 6, 1998, filed with the Securities and Exchange Commission and incorporated herein by reference.

Inflation has not had a substantial impact on the Company's operating revenues and costs; energy payments for electricity for the Coso Project, Partnership Project, Salton Sea II Project and Salton Sea III Project will continue to be based upon scheduled rates and are not adjusted for inflation through the initial ten year period after the dates of firm operation under each power purchase agreement.

The Company has commenced, for all of its information systems, a year 2000 date conversion project to address all necessary code changes, testing and implementation. The "Year 2000 Computer Problem" creates risk for the Company from unforeseen problems in its own computer systems and from third parties with whom the Company deals on financial transactions worldwide. Such failures of the Company's and/or third parties' computer systems could have a material impact on the Company's ability to conduct its business, and especially to process and account for the transfer of funds electronically. Management believes that the year 2000 implementation costs and related potential effect should not have a material financial impact on the Company.

# Consolidated Balance Sheets

As of December 31, 1997 and 1996

Dollars and Shares in Thousands, Except Per Share Amounts

<i>Assets</i>	1997	1996
Cash and cash equivalents (Note 3)	\$ 1,445,338	\$ 424,500
Joint venture cash and investments	6,072	47,764
Restricted cash	223,636	106,968
Short-term investments	1,282	4,921
Accounts receivable	376,745	342,307
Properties, plants, contracts and equipment, net	3,528,910	3,225,496
Excess of cost over fair value of net assets acquired, net	1,312,788	790,920
Equity investments	238,025	238,856
Deferred charges and other assets	354,830	448,424
<b>Total assets</b>	<b>\$ 7,487,626</b>	<b>\$ 5,630,156</b>
<b><i>Liabilities and Stockholders' Equity</i></b>		
<b>Liabilities:</b>		
Accounts payable	\$ 173,610	\$ 218,164
Other accrued liabilities	1,106,641	668,612
Parent company debt	1,303,845	1,146,685
Subsidiary and project debt	2,189,007	1,678,392
Deferred income taxes	509,059	469,199
<b>Total liabilities</b>	<b>5,282,162</b>	<b>4,181,052</b>
Deferred income	40,837	29,067
<b>Commitments and contingencies (Notes 3, 18, 19 and 20)</b>		
<b>Company—obligated mandatorily redeemable</b>		
convertible preferred securities of subsidiary trusts	553,930	103,930
Preferred securities of subsidiary	56,181	136,065
Minority interest	134,454	299,252
Common stock and options subject to redemption	654,736	—
<b>Stockholders' equity:</b>		
Preferred stock—authorized 2,000 shares, no par value	—	—
Common stock—par value \$.0675 per share, authorized 180,000 shares, issued 82,980 and 63,747 shares, outstanding 81,322 and 63,448 shares, respectively	5,602	4,303
Additional paid in capital	1,261,081	563,567
Retained earnings	213,493	297,520
Cumulative effect of foreign currency translation adjustment	(3,589)	29,658
Common stock and options subject to redemption	(654,736)	—
Treasury stock—1,658 and 299 common shares at cost	(56,525)	(8,787)
Unearned compensation—restricted stock	—	(5,471)
<b>Total stockholders' equity</b>	<b>765,326</b>	<b>880,790</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 7,487,626</b>	<b>\$ 5,630,156</b>

The accompanying notes are an integral part of these financial statements.



# Consolidated Statements of Operations

For the Three Years Ended December 31, 1997

Dollars and Shares in Thousands, Except Per Share Amounts

	1997	1996	1995
<b>Revenue:</b>			
Operating revenue	\$ 2,166,338	\$ 518,934	\$ 335,630
Interest and other income	104,573	57,261	63,093
<b>Total revenues</b>	<b>2,270,911</b>	<b>576,195</b>	<b>398,723</b>
<b>Costs and expenses:</b>			
Cost of sales	1,055,195	31,840	—
Operating expense	345,833	132,655	103,602
General and administration	52,705	21,451	23,376
Depreciation and amortization	276,041	118,586	72,249
Loss on equity investment in Casecan	5,972	5,221	362
Interest expense	296,364	165,900	134,637
Less interest capitalized	(45,059)	(39,862)	(32,554)
Non-recurring charge—asset valuation impairment	87,000	—	—
<b>Total costs and expenses</b>	<b>2,074,051</b>	<b>435,791</b>	<b>301,672</b>
Income before provision for income taxes	196,860	140,404	97,051
Provision for income taxes	99,044	41,821	30,631
Income before minority interest	97,816	98,583	66,420
Minority interest	45,993	6,122	3,005
Income before extraordinary item	51,823	92,461	63,415
Extraordinary item, net of minority interest of \$58,222	(135,850)	—	—
Net income (loss)	(84,027)	92,461	63,415
Preferred dividends	—	—	1,080
Net income (loss) available to common stockholders	\$ (84,027)	\$ 92,461	\$ 62,335
Income per share before extraordinary item	\$ 0.77	\$ 1.69	\$ 1.32
Extraordinary item	\$ (2.02)	\$ —	\$ —
Net income (loss) per share	\$ (1.25)	\$ 1.69	\$ 1.32
Income per share before extraordinary item—diluted	\$ 0.75	\$ 1.54	\$ 1.22
Extraordinary item—diluted	\$ (1.97)	\$ —	\$ —
Net income (loss) per share—diluted	\$ (1.22)	\$ 1.54	\$ 1.22

The accompanying notes are an integral part of these financial statements.

# Consolidated Statements of Stockholders' Equity

For the Three Years Ended December 31, 1997

Dollars and Shares in Thousands

	Common Stock								
	Outstanding Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Foreign Currency Adjust.	& Options Subject to Redemption	Treasury Stock	Unearned Compensation	Total
Balance December 31, 1994	31,849	\$ 2,407	\$ 100,421	\$ 142,937	\$ —	\$ —	\$ (65,774)	\$ —	\$ 179,991
Equity offering	18,170	1,004	240,825	—	—	—	56,801	—	298,630
Restricted stock	500	—	848	—	—	—	8,652	(9,500)	—
Exercise of stock options and other equity transactions	176	10	446	—	—	—	563	2,494	3,513
Purchase of treasury stock	(102)	—	—	—	—	—	(1,590)	—	(1,590)
Preferred stock dividends, Series C, including cash distribution of \$43	—	—	—	(1,293)	—	—	—	—	(1,293)
Tax benefit from stock plan	—	—	866	—	—	—	—	—	866
Net income before preferred dividends	—	—	—	63,415	—	—	—	—	63,415
Balance December 31, 1995	50,593	3,421	343,406	205,059	—	—	(1,348)	(7,006)	543,532
Exercise of stock options and other equity transactions	5,263	337	53,030	—	—	—	4,569	1,535	59,471
Purchase of treasury stock	(472)	—	—	—	—	—	(12,008)	—	(12,008)
Conversion of debt	8,064	545	164,912	—	—	—	—	—	165,457
Tax benefit from stock plan	—	—	2,219	—	—	—	—	—	2,219
Foreign currency translation adjustment	—	—	—	—	29,658	—	—	—	29,658
Net income	—	—	—	92,461	—	—	—	—	92,461
Balance December 31, 1996	63,448	4,303	563,567	297,520	29,658	—	(8,787)	(5,471)	880,790
Equity offering	19,100	1,289	697,315	—	—	—	—	—	698,604
Exercise of stock options and other equity transactions	396	10	(2,757)	—	—	—	7,767	5,471	10,491
Purchase of treasury stock	(1,622)	—	—	—	—	—	(55,505)	—	(55,505)
Common stock and options subject to redemption	—	—	—	—	—	(654,736)	—	—	(654,736)
Tax benefit from stock plan	—	—	2,956	—	—	—	—	—	2,956
Foreign currency translation adjustment	—	—	—	—	(33,247)	—	—	—	(33,247)
Net loss	—	—	—	(84,027)	—	—	—	—	(84,027)
Balance December 31, 1997	81,322	\$ 5,602	\$ 1,261,081	\$ 213,493	\$ (3,589)	\$ (654,736)	\$ (56,525)	\$ —	\$ 765,326

The accompanying notes are an integral part of these financial statements.

# Consolidated Statements of Cash Flows

For the Three Years Ended December 31, 1997

Dollars in Thousands

	1997	1996	1995
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ (84,027)	\$ 92,461	\$ 63,415
<b>Adjustments to reconcile net cash flow from operating activities:</b>			
Non-recurring charge-asset valuation impairment	87,000	—	—
Depreciation and amortization	239,234	109,447	65,244
Amortization of excess of cost over fair value of net assets acquired	36,807	9,139	7,005
Amortization of original issue discount	2,160	50,194	45,409
Amortization of deferred financing costs	26,161	9,677	8,979
Amortization of unearned compensation	5,471	1,535	2,494
Provision for deferred income taxes	55,584	12,252	13,983
Loss (income) on equity investments	(16,068)	(910)	362
Income (loss) applicable to minority interest	(35,387)	1,431	3,005
Changes in other items:			
Accounts receivable	(34,146)	(13,936)	213
Accounts payable, accrued liabilities and deferred income	29,799	2,093	12,103
<b>Net cash flows from operating activities</b>	<b>312,588</b>	<b>273,383</b>	<b>222,212</b>
<b>Cash flows from investing activities:</b>			
Purchase of Northern, Falcon Seaboard, Partnership Interest and Magma, net of cash acquired	(632,014)	(474,443)	(907,614)
Distributions from equity investments	23,960	8,222	—
Capital expenditures relating to operating projects	(194,224)	(24,821)	(27,120)
Philippine construction	(27,334)	(167,160)	(289,655)
Indonesian and other development	(155,963)	(81,068)	(8,973)
Salton Sea IV construction	—	(63,772)	(62,430)
Pacific Northwest, Nevada, and Utah exploration costs	(3,128)	(4,885)	(10,445)
Decrease in short-term investments	2,880	33,998	80,565
Decrease (increase) in restricted cash	(116,668)	63,175	(17,452)
Other	60,390	(2,910)	11,514
Investment in Casecan	—	—	(61,177)
<b>Net cash flows from investing activities</b>	<b>(1,042,101)</b>	<b>(713,664)</b>	<b>(1,292,787)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from sale of common and treasury stock and exercise of stock options	703,624	54,935	299,649
Proceeds from convertible preferred securities of subsidiary trusts	450,000	103,930	—
Proceeds from issuance of parent company debt	350,000	324,136	200,000
Repayment of parent company debt	(100,000)	—	—
Net proceeds from revolver	(95,000)	95,000	—
Proceeds from subsidiary and project debt	795,658	428,134	654,695
Repayments of subsidiary and project debt	(271,618)	(210,892)	(176,664)
Deferred charges relating to debt financing	(48,395)	(36,010)	(34,733)
Purchase of treasury stock	(55,505)	(12,008)	(1,590)
Other	13,142	10,756	(29,169)
<b>Net cash flows from financing activities</b>	<b>1,741,906</b>	<b>757,981</b>	<b>912,188</b>
Effect of exchange rate changes	(33,247)	4,860	—
<b>Net increase (decrease) in cash and investments</b>	<b>979,146</b>	<b>322,560</b>	<b>(158,387)</b>
Cash and cash equivalents at beginning of year	472,264	149,704	308,091
<b>Cash and cash equivalents at end of year</b>	<b>\$ 1,451,410</b>	<b>\$ 472,264</b>	<b>\$ 149,704</b>
<b>Supplemental Disclosures:</b>			
Interest paid (net of amounts capitalized)	\$ 316,060	\$ 92,829	\$ 50,840
Income taxes paid	\$ 44,483	\$ 23,211	\$ 14,812

The accompanying notes are an integral part of these financial statements.

# Notes to Consolidated Financial Statements

For the Three Years Ended December 31, 1997

Dollars, Pounds and Shares in Thousands, Except Per Share Amounts

## 1. Business

CalEnergy Company, Inc. (the "Company") is a United States-based global power company which generates, distributes and supplies electricity to utilities, government entities, retail customers and other customers located throughout the world. The Company was founded in 1971 and through its subsidiaries is primarily engaged in the development, ownership and operation of environmentally responsible independent power production facilities worldwide utilizing geothermal, natural gas, hydroelectric and other energy sources. In addition, the Company is engaged in the distribution and supply of electricity to approximately 1.5 million customers primarily in northeast England as well as the generation and supply of electricity (together with other related business activities) throughout England and Wales. The Company is also active in supplying gas and has applications for over 400,000 customers in those areas of England, Wales and Scotland where retail gas competition has been introduced.

The Company has organized several partnerships and joint ventures (herein referred to as the "Coso Joint Ventures") in order to develop geothermal energy at the China Lake Naval Air Weapons Station, Coso Hot Springs, China Lake, California. Collectively, the projects undertaken by these Coso Joint Ventures are referred to as the Coso Project. In 1992, the Company entered into the natural gas-fired electrical generation market through the purchase of a development opportunity in Yuma, Arizona which commenced commercial operation in May 1994. In 1993, the Company started developing a number of international power project opportunities where private power generating programs have been initiated, including the Philippines and Indonesia.

In 1995, the Company acquired Magma Power Company ("Magma"). Magma's operating assets included four projects referred to as the Partnership Project in which Magma had a 50% interest, and three projects referred to as the Salton Sea Project of which Magma owned 100%. A fourth project included in the Salton Sea Project was constructed after the acquisition of Magma and commenced operations in June 1996. In addition, in April 1996, the Company acquired the remaining 50% interest in the Partnership Project. In August 1996, the Company acquired Falcon Seaboard Resources, Inc. ("Falcon Seaboard") which includes significant interests in three operating gas-fired cogeneration facilities and a related natural gas pipeline. On December 24, 1996, CE Electric UK plc ("CE Electric"), which in 1997 was 70% owned indirectly by the Company and 30% owned indirectly by Peter Kiewit Sons', Inc. ("PKS"), acquired majority ownership of the outstanding ordinary share capital of Northern Electric plc ("Northern") pursuant to a tender offer ("Tender Offer"). As of March 18, 1997, CE Electric effectively owned 100% of Northern ordinary shares.

Northern is one of the twelve regional electricity companies ("RECs") which came into existence as a result of the restructuring and subsequent privatization of the electricity industry in the United Kingdom in 1990. Northern is primarily engaged in the distribution and supply of electricity. Northern was granted a Public Electricity Supply ("PES") license under the Electricity Act to supply electricity in Northern's Authorized Area ("Authorized Area"). Northern's Authorized

Area covers approximately 14,400 square kilometers with a population of approximately 3.2 million people and includes the counties of Northumberland, Tyne and Wear, Durham, Cleveland and North Yorkshire. Northern supplies electricity outside its Authorized Area pursuant to second tier licenses. Northern also is involved in non-regulated activities, including the supply of gas within England, Wales and Scotland, the generation of electricity, electrical appliance retailing and gas exploration and production.

## *2. Summary of Significant Accounting Policies*

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, and its proportionate share of the partnerships and joint ventures in which it has an undivided interest in the assets and is proportionally liable for its share of liabilities. Other investments and corporate joint ventures where the Company has the ability to exercise significant influence are accounted for under the equity method of accounting. Investments, where the Company's ability to influence is limited, are accounted for under the cost method of accounting. All significant inter-enterprise transactions and accounts have been eliminated. The results of operations of the Company include the Company's proportionate share of results of operations of entities acquired as of the date of each acquisition.

### *Cash Equivalents, Investments and Restricted Cash*

The Company considers all investment instruments purchased with an original maturity of three months or less to be cash equivalents. Restricted cash is not considered a cash equivalent.

Investments other than restricted cash are primarily commercial paper and money market securities. The restricted cash balance includes such securities and mortgage backed securities, and is mainly composed of amounts deposited in restricted accounts from which the Company will source its equity contributions and debt service reserve requirements relating to the projects. These funds are restricted by their respective project debt agreements to be used only for the related project.

At December 31, 1997, all of the Company's investments are classified as held-to-maturity and are accounted for at their amortized cost basis. The carrying amount of the investments approximates the fair value based on quoted market prices as provided by the financial institution which holds the investments.

### *Properties, Plants, Contracts, Equipment and Depreciation*

The cost of major additions and betterments are capitalized, while replacements, maintenance, and repairs that do not improve or extend the lives of the respective assets are expensed.

Depreciation of the operating power plant costs, net of salvage value, is computed on the straight line method over the estimated useful lives, between 10 and 30 years. Depreciation of furniture, fixtures and equipment which are recorded at cost, is computed on the straight line method over the estimated useful lives of the related assets, which range from three to ten years.

The Northern, Falcon Seaboard, Partnership Interest and Magma acquisitions by the Company have been accounted for as purchase business combinations. All identifiable assets acquired and liabilities assumed were assigned a portion of the cost of acquiring the respective companies equal to their fair values at the date of the acquisition and include the following:

Property and equipment of Northern is depreciated using a systematic method, which approximates the straight line method over the estimated useful lives of the related assets which range from 3-40 years.

Power sales agreements are amortized separately over (1) the remaining portion of the scheduled price periods of the power sales agreements and (2) for the Partnership Interest and Magma acquisitions the 20 year avoided cost periods of the power sales agreements using the straight line method.

Capitalized costs for gas reserves, other than costs of unevaluated exploration projects and projects awaiting development consent, are depleted using the unit of production method. Depletion is calculated based on hydrocarbon reserves of properties in the evaluated pool estimated to be commercially recoverable and include anticipated future development costs in respect of those reserves.

Expenditures on major information technology systems are capitalized and depreciated on a straight line basis over the useful life of the developed systems which range from 3-10 years.

#### *Well, Resource Development and Exploration Costs*

The Company follows the full cost method of accounting for costs incurred in connection with the exploration and development of geothermal and natural gas resources. All such costs, which include dry hole costs and the cost of drilling and equipping production wells and directly attributable administrative and interest costs, are capitalized and amortized over their estimated useful lives when production commences. The estimated useful lives of production wells are ten to twenty years depending on the characteristics of the underlying resource; exploration costs and development costs, other than production wells, are generally amortized over the weighted average remaining term of the Company's power and steam purchase contracts.

#### *Excess of Cost Over Fair Value*

Total acquisition costs in excess of the fair values assigned to the net assets acquired are amortized over a 40 year period for the Northern and Magma acquisitions and a 25 year period for the Falcon Seaboard acquisition, both using the straight line method.

#### *Impairment of Long-Lived Assets*

The Company reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized whenever evidence exists that the carrying value is not recoverable.

*Deferred Well and Rework Costs*

Well rework costs are deferred and amortized over the estimated period between reworks. These deferred costs, net of accumulated amortization, are \$5,421 and \$8,371 at December 31, 1997 and 1996, respectively, and are included in other assets.

*Revenue Recognition*

Revenues are recorded based upon service rendered and electricity and steam delivered, distributed or supplied to the end of the month. Where there is an overrecovery of supply or distribution business revenues against the maximum regulated amount, revenues are deferred equivalent to the overrecovered amount. The deferred amount is deducted from revenue and included in other liabilities. Where there is an underrecovery, no anticipation of any potential future recovery is made.

*Capitalization of Interest and Deferred Financing Costs*

Prior to the commencement of operations, interest is capitalized on the costs of the plants and geothermal resource development to the extent incurred. Capitalized interest and other deferred charges are amortized over the lives of the related assets.

Deferred financing costs are amortized over the term of the related financing using the effective interest method.

*Deferred Income Taxes*

The Company recognizes deferred tax assets and liabilities based on the difference between the financial statement and tax bases of assets and liabilities using estimated tax rates in effect for the year in which the differences are expected to reverse. The Company intends to repatriate earnings of foreign subsidiaries in the foreseeable future. As a result, deferred income taxes are provided for retained earnings of international subsidiaries and corporate joint ventures which are intended to be remitted.

*Fair Values of Financial Instruments*

The following methods and assumptions were used by the Company in estimating fair values of financial instruments as discussed herein. Fair values have been estimated based on quoted market prices for debt issues listed on exchanges. Fair values of financial instruments that are not actively traded are based on market prices of similar instruments and/or valuation techniques using market assumptions.

The Company assumes that the carrying amount of short-term financial instruments approximates their fair value. For these purposes, short-term is defined as any item that matures, reprices, or represents a cash transaction between willing parties within six months or less of the measurement date.

*Pensions*

Northern contributes to the Electricity Supply Pension Scheme and contributions to the scheme are charged to the income statement. The capital cost of ex gratia and supplementary pensions are normally charged to the income statement in the period in which they are granted. Variations in pension cost, which are identified as a result of actuarial valuations/reviews, are amortized over the average expected remaining working lives of employees in proportion to their expected payroll costs. Differences between the amounts funded and the amounts charged to the profit and loss account are treated as either provisions or prepayments in the balance sheet.

*Net Income per Common Share*

In February 1997, the Financial Accounting Standards Board ("FASB") adopted Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." SFAS 128 replaced primary and fully diluted earnings per share with basic and diluted earnings per share, respectively.

Basic and diluted earnings per common share are based on the weighted average number of common shares outstanding during the period. Diluted earnings per common share also assumes the conversion of the convertible preferred securities of subsidiary trusts, when

dilutive, and the exercise of all dilutive stock options outstanding at their option prices, with the option exercise proceeds and tax benefits used to repurchase shares of common stock at the average market price using the treasury stock method.

A reconciliation of basic earnings per share before extraordinary item to diluted earnings per share before extraordinary item follows:

	1997			1996			1995		
	Income	Shares	Per-Share Amount	Income	Shares	Per-Share Amount	Income	Shares	Per-Share Amount
Basic earnings per share before extraordinary item	\$ 51,823	67,268	\$ 0.77	\$ 92,461	54,739	\$ 1.69	\$ 62,335	47,249	\$ 1.32
Effect of dilutive securities									
Stock options	—	1,418		—	1,881		—	1,688	
Convertible preferred securities of subsidiary trusts <sup>(1)</sup>	—	—		2,840	2,517		—	—	
Convertible debt	—	—		4,968	5,935		6,038	7,258	
Diluted earnings per share before extraordinary item	\$ 51,823	68,686	\$ 0.75	\$ 100,269	65,072	\$ 1.54	\$ 68,373	56,195	\$ 1.22

(1) The convertible preferred securities of subsidiary trusts were antidilutive in 1997.

### Reclassification

Certain amounts in the fiscal 1996 and 1995 financial statements and supporting footnote disclosures have been reclassified to conform to the fiscal 1997 presentation. Such reclassification did not impact previously reported net income or retained earnings.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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.

### New Accounting Pronouncements

In June 1997, the FASB adopted SFAS No. 130, "Reporting Comprehensive Income", and No. 131, "Disclosures about Segments of an Enterprise and Related Information". SFAS 130 establishes standards for reporting and display of comprehensive income and its components in a full set of general purpose financial statements. SFAS 131 redefines how operating segments are determined and requires disclosure of certain financial and descriptive information about a company's operating segments. Both statements will be effective for the Company beginning January 1, 1998. The Company has not yet determined the impact of these statements on current disclosures.



### 3. KDG Acquisition

On September 11, 1997, the Company signed a definitive agreement with Kiewit Diversified Group ("KDG"), a wholly owned subsidiary of PKS, for the Company to purchase KDG's ownership interest in various project partnerships and CalEnergy common shares (the "KDG Acquisition"). Accordingly, common stock and options subject to redemption have been reclassified in the consolidated balance sheet.

KDG's ownership interest in CalEnergy comprised approximately 20,231 shares of common stock (assuming exercise by KDG of one million options to purchase CalEnergy shares), the 30% interest in Northern Electric, as well as the following minority project interests: Mahanagdong (45%), Casenlan (35%), Dieng (47%), Patuha (44%) and Bali (30%) and other interests in international development stage projects.

CalEnergy paid \$1,159,215 for the KDG Acquisition and final closing of the transaction occurred in January 1998. CalEnergy funded this acquisition with available cash and the net proceeds of the equity offering and the debt offering completed in October 1997.

### 4. Acquisitions

#### *Northern*

On December 24, 1996, CE Electric UK plc ("CE Electric"), which in 1997 was 70% owned indirectly by the Company and 30% owned indirectly by PKS, acquired majority ownership of the outstanding ordinary share capital of Northern Electric plc ("Northern") pursuant to a tender offer (the "Northern Tender Offer") commenced in the United Kingdom on November 5, 1996. As of March 18, 1997, CE Electric effectively acquired the remaining ordinary shares and owned 100% of Northern's ordinary shares.

The Company and PKS contributed to CE Electric approximately \$410,000 and \$176,000 respectively, of the approximately \$1,200,000 required to acquire all of Northern's ordinary and preference shares in connection with the Tender Offer. The Company obtained such funds from cash on hand, short-term borrowings, and borrowings of approximately \$100,000 under a Credit Agreement entered into with Credit Suisse on October 28, 1996 (the "CalEnergy Credit Facility"). The Company has repaid the entire CalEnergy Credit Facility through the use of proceeds of the Trust Securities offering. The remaining funds necessary to consummate the Tender Offer were provided from a £560,000 Term Loan and Revolving Facility Agreement, dated October 28, 1996 (the "U.K. Credit Facility"). CE Electric has repaid the entire U.K. Credit Facility through the use of proceeds of the senior note and sterling bond offerings of CE Electric UK Funding Company.

The Northern acquisition has been accounted for as a purchase business combination. All identifiable assets acquired and liabilities assumed were assigned a portion of the cost of acquiring Northern, equal to their fair values at the date of the acquisition. Minority interest was recorded at historical cost.

In 1993, Northern entered into a contract relating to the purchase of 400 MW of capacity from a 15.4% owned related party, Teesside Power Limited ("Teesside"), for a period of 15 years beginning April 1, 1993. The contract sets escalating purchase prices at predetermined levels. Currently the escalating contract prices exceed those paid by the Company to the electricity pool (the "Pool") which is operated by the National Grid Group. However, under current price cap regulation expected to expire in 1998 the Company is able to recover these costs. For the period after the price cap regulation ends, the Company has established a liability for the estimated loss as a result of this contract.

Northern utilizes contracts for differences ("CFDs") to mitigate its exposure to volatility in the prices of electricity purchased through the Pool. Such contracts allow the Company to effectively convert the majority of its anticipated Pool purchases from market to fixed prices. As of December 31, 1997, CFDs were in place to hedge a portion of electricity purchases of approximately 55,000 GWh through the year 2008.

#### *Falcon Seaboard*

On August 7, 1996 the Company completed the acquisition of Falcon Seaboard for a cash price of \$229,500 including acquisition costs. Through the acquisition, the Company indirectly acquired significant ownership interests in three operating gas-fired cogeneration facilities and a related natural-gas pipeline. The plants are located in Texas, Pennsylvania and New York and total 520 MW in capacity.

The Falcon Seaboard acquisition has been accounted for as a purchase business combination. All identifiable assets acquired and liabilities assumed were assigned a portion of the cost of acquiring Falcon Seaboard, equal to their fair values at the date of the acquisition.

#### *Edison Mission Energy's Partnership Interest*

On April 17, 1996 the Company completed the acquisition of Edison Mission Energy's Partnership Interests in four geothermal operating facilities in California for a cash purchase price of \$71,000 including acquisition costs. The four projects, Vulcan, Hoch (Del Ranch), Leathers and Elmore, are located in the Imperial Valley of California. Prior to this transaction, the Company was a 50% owner of these facilities.

The Partnership Interest acquisition has been accounted for as a purchase business combination. All identifiable assets acquired and liabilities assumed were assigned a portion of the cost of acquiring the Partnership Interest, equal to their fair values at the date of the acquisition.

Unaudited pro forma combined revenue, income and basic earnings per share before extraordinary item of the Company, Northern, Falcon Seaboard, and the Partnership Interest for the twelve months ended December 31, 1997 and 1996, as if the acquisitions had occurred at the beginning of 1996 after giving effect to certain pro forma adjustments related to the acquisitions were \$2,270,911, \$52,430, and \$0.78 compared to \$2,162,381, \$64,811 and \$1.18, respectively. Excluding the \$87,000, \$1.29 per share, non-recurring charge, pro forma income before extraordinary item would have been \$139,430 in 1997.

### 5. Properties, Plants, Contracts and Equipment

Properties, plants, contracts and equipment comprise the following at December 31:

	1997	1996
Operating project costs:		
Distribution system	\$ 1,237,743	\$ 928,575
Power plants	1,464,885	1,277,663
Wells and resource development	395,314	377,731
Power sales agreements	227,535	227,535
Other assets	254,973	176,483
Total operating assets	3,580,450	2,987,987
Less accumulated depreciation and amortization	(497,832)	(271,216)
Net operating assets	3,082,618	2,716,771
Mineral and gas reserves, net	297,048	270,851
Construction in progress:		
Malibog	—	152,411
Indonesia	140,172	81,875
Other development	9,072	3,588
Total	\$ 3,528,910	\$ 3,225,496

### Coso Project Operating Facilities

The Coso Project operating facilities comprise the Company's proportionate share of the assets of three of its Coso Joint Ventures: Coso Finance Partners ("Navy I Joint Venture"), Coso Energy Developers ("BLM Joint Venture"), and Coso Power Developers ("Navy II Joint Venture"). The Navy I power plant is located on land owned by and leased from the U.S. Navy to December 2009, with a 10 year extension at the option of the Navy. Under terms of the Navy I Joint Venture, current profits and losses are allocated 46.4% to the Company. The BLM power plant is situated on lands leased from the U.S. Bureau of Land Management under a geothermal lease agreement that extends until October 31, 2035. The lease may be extended to 2075 at the option of the BLM. Under the terms of the BLM Joint Venture agreement, the Company's share of profits and losses is 48%. Under terms of the Navy II Joint Venture, all profits, losses and capital contributions for Navy II are divided equally by the two partners.

The amount of royalties paid by Navy I to the U.S. Navy to develop geothermal energy for Navy I, Unit 1 on the lands owned by the Navy comprises (i) a fee payable during the term of the contract based on the difference between the amounts paid by the Navy to Edison for specified quantities of electricity and the price as determined under the contract (which currently approximates 73% of that paid by the Navy to Edison), and (ii) \$25,000 payable in December 2009, of which the Company's share is \$11,600. The \$25,000 payment is secured by funds placed on deposit monthly, which funds, plus accrued interest, will aggregate \$25,000. The monthly deposit is currently \$50. As of December 31, 1997, the balance of funds deposited approximated \$6,337, which amount is included in restricted cash.

Units 2 and 3 of Navy I and the Navy II power plants are on Navy lands, for which the Navy receives a royalty based on electric sales revenue at the initial rate of 4% escalating to 22% by the end of the contract in December 2019. The BLM is paid a royalty of 10% of the value of steam produced by the geothermal resource supplying the BLM Plant.

The Coso Joint Ventures had royalty expense included in operating expenses of \$13,458, \$13,412 and \$13,623 in the years ended December 31, 1997, 1996 and 1995, respectively.

#### *Imperial Valley Project Operating Facilities*

The Company currently operates eight geothermal power plants in the Imperial Valley in California. The Partnership Project consists of the Vulcan, Hoch (Del Ranch), Elmore, and Leathers Partnerships. The remaining four plants which comprise the Salton Sea Project are indirect wholly owned subsidiaries of the Company. These geothermal power plants consist of Salton Sea I, Salton Sea II, Salton Sea III and Salton Sea IV. The Partnership Project and the Salton Sea Project are collectively referred to as the Imperial Valley Project. The Imperial Valley Project commencement dates and nominal capacities are as follows:

Imperial Valley Plants	Commencement Date	Nominal Capacity
Vulcan	February 10, 1986	34 MW
Hoch (Del Ranch)	January 2, 1989	38 MW
Elmore	January 1, 1989	38 MW
Leathers	January 1, 1990	38 MW
Salton Sea I	July 1, 1987	10 MW
Salton Sea II	April 5, 1990	20 MW
Salton Sea III	February 13, 1989	49.8 MW
Salton Sea IV	May 24, 1996	39.6 MW

The Partnership Project pays royalties based on both energy revenues and total electricity revenues. Hoch (Del Ranch) and Leathers pay royalties of approximately 5% of energy revenues and 1% of total electricity revenue. Elmore pays royalties of approximately 5% of energy revenues. Vulcan pays royalties of 4.167% of energy revenues.

The Salton Sea Project's weighted average royalty expense in 1997 was approximately 6.1%. The royalties are paid to numerous recipients based on varying percentages of electrical revenue or steam production multiplied by published indices.

The Imperial Valley Projects had royalty expense included in operating expenses of \$14,343, \$10,228 and \$10,398 in the years ended December 31, 1997, 1996 and 1995, respectively.

#### *Significant Customers and Contracts*

All of the Company's sales of electricity from the Coso Project and Imperial Valley Project, which comprise approximately 20% of 1997 operating revenue, are to Southern California Edison Company ("Edison") and are under long-term power purchase contracts.

The Coso Project and the Partnership Project sell all electricity generated by the respective plants pursuant to seven long-term SO4 Agreements between the projects and Edison. These SO4 Agreements provide for capacity payments, capacity bonus payments and energy payments. Edison makes fixed annual capacity and capacity bonus payments to the projects to the extent that capacity factors exceed certain benchmarks. The price for capacity and capacity bonus payments is fixed for the life of the SO4 Agreements. Energy is sold at increasing scheduled rates for the first ten years after firm operation and thereafter at Edison's Avoided Cost of Energy.

The scheduled energy price periods of the Coso Project SO4 Agreements extended until at least August 1997 for each of the units operated by the Navy I Partnership and extend until at least March 1999 and January 2000 for each of the units operated by the BLM and Navy II Partnerships, respectively. The Company's share of aggregate annual capacity payments is approximately \$17,000 and its share of aggregate bonus payments is approximately \$3,000.

The scheduled energy price periods of the Partnership Project SO4 Agreements extended until February 1996 for the Vulcan Partnership and extend until December 1998, December 1998, and December 1999 for each of the Hoch (Del Ranch), Elmore and Leathers Partnerships, respectively. The annual capacity payments are approximately \$24,500 and the bonus payments are approximately \$4,400 in aggregate for the four plants.

Excluding Navy I and Vulcan, which are receiving Edison's Avoided Cost of Energy, the Company's SO4 Agreements provide for energy rates ranging from 12.8¢ per kWh in 1997 to 15.6¢ per kWh in 1999. The weighted average energy rate for all of the Company's SO4 Agreements was 12.0¢ per kWh in 1997.

Salton Sea I sells electricity to Edison pursuant to a 30-year negotiated power purchase agreement, as amended (the "Salton Sea I PPA"), which provides for capacity and energy payments. The energy payment is calculated using a Base Price which is subject to quarterly adjustments based on a basket of indices. The time period weighted average energy payment for Salton Sea I was 5.3¢ per kWh during 1997. As the Salton Sea I PPA is not an SO4 Agreement, the energy payments do not revert to Edison's Avoided Cost of Energy. The capacity payment is approximately \$1,100 per annum.

Salton Sea II and Salton Sea III sell electricity to Edison pursuant to 30-year modified SO4 Agreements that provide for capacity payments, capacity bonus payments and energy payments. The price for contract capacity and contract capacity bonus payments is fixed for the life of the modified SO4 Agreements. The energy payments for the first ten year period, which period expires in April 2000 and February 1999 are levelized at a time period weighted average of 10.6¢ per kWh and 9.8¢ per kWh for Salton Sea II and Salton Sea III, respectively. Thereafter, the monthly energy payments will be Edison's Avoided Cost of Energy. For Salton Sea II only, Edison is entitled to receive, at no cost, 5% of all energy delivered in excess of 80% of contract capacity through September 30, 2004. The annual capacity and bonus payments for Salton Sea II and Salton Sea III are approximately \$3,300 and \$9,700, respectively.

The Salton Sea IV Project sells electricity to Edison pursuant to a modified SO4 agreement which provides for contract capacity payments on 34 MW of capacity at two different rates based on the respective contract capacities deemed attributable to the original Salton Sea PPA option (20 MW) and to the original Fish Lake PPA (14 MW). The capacity payment price for the 20 MW portion adjusts quarterly based upon specified indices and the capacity payment price for the 14 MW portion is a fixed levelized rate. The energy payment (for deliveries up to a rate of 39.6 MW) is at a fixed price for 55.6% of the total energy delivered by Salton Sea IV and is based on an energy payment schedule for 44.4% of the total energy delivered by Salton Sea IV. The contract has a 30-year term but Edison is not required to purchase the 20 MW of capacity and energy originally attributable to the Salton Sea I PPA option after September 30, 2017, the original termination date of the Salton Sea I PPA.

For the year ended December 31, 1997, and 1996 Edison's average Avoided Cost of Energy was 3.3¢ and 2.5¢, respectively, per kWh which is substantially below the contract energy prices earned for the year ended December 31, 1997. Estimates of Edison's future Avoided Cost of Energy vary substantially from year to year. The Company cannot predict the likely level of Avoided Cost of Energy prices under the SO4 Agreements and the modified SO4 Agreements at the expiration of the scheduled payment periods. The revenues generated by each of the projects operating under SO4 Agreements could decline significantly after the expiration of the respective scheduled payment periods.

#### *Philippine Projects*

The Upper Mahiao Project was deemed complete in June 1996 and began receiving capacity payments pursuant to the Upper Mahiao Energy Conversion Agreement ("ECA"), in July of 1996. The project is structured as a ten year build-own-operate-transfer project ("BOOT"), in which the Company's subsidiary CE Cebu Geothermal Power Company, Inc. ("CE Cebu"), the project company, is responsible for providing operations and maintenance during the ten year BOOT period. The electricity generated by the Upper Mahiao geothermal power plant is sold to PNOC-Energy Development Corporation ("PNOC-EDC"), which is also responsible for supplying the facility with the geothermal steam. After the ten year cooperation period, and the recovery by the Company of its capital investment plus incremental return, the plant will be transferred to PNOC-EDC at no cost.

PNOC-EDC is obligated to pay for electric capacity that is nominated each year by CE Cebu, irrespective of whether PNOC-EDC is willing or able to accept delivery of such capacity. PNOC-EDC pays to CE Cebu a fee (the "Capacity Fee") based on the plant capacity nominated to PNOC-EDC in any year (which, at the plant's design capacity, is approximately 95% of total contract revenues) and a fee (the "Energy Fee") based on the electricity actually delivered to PNOC-EDC (approximately 5% of total contract revenues). Payments under the Upper Mahiao ECA are denominated in U.S. Dollars, or computed in U.S. dollars and paid in Philippine pesos at the then-current exchange rate, except for the Energy Fee. Significant portions of the Capacity Fee and Energy Fee are indexed to U.S. and Philippine inflation rates, respectively. PNOC-EDC's payment requirements, and its other obligations under the Upper Mahiao ECA are supported by the Government of the Philippines through a performance undertaking.

Unit I of the Malitbog Project (the "Malitbog Project") was deemed complete in July 1996 and Units II and III in July 1997 at which times such units commenced receiving capacity payments under the Malitbog ECA. The Malitbog Project is owned and operated by Visayas Geothermal Power Company ("VGPC"), a Philippine general partnership that is wholly owned, indirectly, by the Company. Under its contract, VGPC is to sell 100% of its output on substantially the same basis as described above for the Upper Mahiao Project to PNOC-EDC, which will in turn sell the power to the National Power Corporation of the Philippines ("NPC"). However, VGPC receives 100% of its revenues from such sales in the form of capacity payments. As with the Upper Mahiao Project, the Malitbog Project

is structured as a ten year BOOT, in which the Company is responsible for providing operations and maintenance for the ten year BOOT period. After a ten year cooperation period, and the recovery by the Company of its capital investment plus incremental return, the plant will be transferred to PNOC-EDC at no cost.

The Mahanagdong Project (the "Mahanagdong Project") was deemed complete in July 1997 and accordingly, the Mahanagdong Project began receiving capacity payments pursuant to the Mahanagdong ECA in August of 1997. The Mahanagdong Project is owned and operated by CE Luzon Geothermal Power Company, Inc., a Philippine corporation, that is expected to be indirectly owned by the Company (after the KDG Acquisition) subject to a minority partner participation. The electricity generated by the Mahanagdong Project will be sold to PNOC-EDC on a "take or pay" basis, which is also responsible for supplying the facility with the geothermal steam. The terms of the Mahanagdong ECA are substantially similar to those of the Upper Mahiao ECA. All of PNOC-EDC's obligations under the Mahanagdong ECA are supported by the Government of the Philippines through a performance undertaking. The capacity fees are expected to be approximately 97% of total revenues at the design capacity levels and the energy fees are expected to be approximately 3% of such total revenues.

### *Gas Projects*

The Saranac Project sells electricity to New York State Electric & Gas pursuant to a 15 year negotiated power purchase agreement (the "Saranac PPA"), which provides for capacity and energy payments. Capacity payments, which in 1997 total 2.2¢ per kWh, are received for electricity produced during "peak hours" as defined in the Saranac PPA and escalate at approximately 4.1% annually for the remaining term of the contract. Energy payments, which average 6.6¢ per kWh in 1997, escalate at approximately 4.4% annually for the remaining term of the Saranac PPA. The Saranac PPA expires in June of 2009.

The Power Resources Project sells electricity to Texas Utilities Electric Company ("TUEC") pursuant to a 15 year negotiated power purchase agreement (the "Power Resources PPA"), which provides for capacity and energy payments. Capacity payments and energy payments, which in 1997 are \$3,032 per month and 2.96¢ per kWh, respectively, escalate at 3.5% annually for the remaining term of the Power Resources PPA. The Power Resources PPA expires in September 2003.

The NorCon Project sells electricity to Niagara Mohawk Power Corporation ("Niagara") pursuant to a 25 year negotiated power purchase agreement (the "NorCon PPA") which provides for energy payments calculated pursuant to an adjusting formula based on Niagara's ongoing Tariff Avoided Cost and the contractual Long-Run Avoided Cost. The NorCon PPA term extends through December 2017. The Company and Niagara are currently engaged in discussions regarding a potential restructuring or buyout and termination of the NorCon PPA.

The Yuma Project sells electricity to SDG&E under an existing 30-year power purchase contract. The energy is sold at SDG&E's Avoided Cost of Energy and the capacity is sold to SDG&E at a fixed price for the life of the power purchase contract. The contract term extends through May 2024.

#### *Nevada and Utah Properties*

*Roosevelt Hot Springs.* The Company operates and owns an approximately 70% interest in a geothermal steam field which supplies geothermal steam to a 23 net MW power plant owned by Utah Power & Light Company ("UP&L") located on the Roosevelt Hot Springs property under a 30-year steam sales contract.

The Company obtained approximately \$20,317 cash under a pre-sale agreement with UP&L whereby UP&L paid in advance for the steam produced by the steam field. The Company must make certain penalty payments to UP&L if the steam produced does not meet certain quantity and quality requirements.

*Desert Peak.* The Company is the owner and operator of a geothermal plant at Desert Peak, Nevada that is currently selling electricity to Sierra Pacific Power Company ("Sierra") at Sierra's Avoided Cost. Subsequent to year end, an indirect subsidiary of the Company entered into a lease agreement whereby they will lease the facility to another power producer and receive rental payments.

#### *Salton Sea Minerals Extraction*

The Company developed and owns the rights to a proprietary process for the extraction of minerals from elements in solution in the geothermal brine and fluids utilized at its Imperial Valley plants (the "Salton Sea Extraction Project") as well as the production of power to be used in the extraction process. A pilot plant has successfully produced commercial quality

zinc at the Company's Imperial Valley Project. The Company is also investigating producing other minerals and silica from the solids precipitated out of the geothermal power process.

#### *Telephone Flat*

Under a Bonneville Power Administration ("BPA") geothermal pilot program, the Company has been developing a 30 net MW net geothermal project which was originally located in the Newberry Known Geothermal Resource Area in Deschutes County, Oregon (the "Telephone Flat Project"). Pursuant to an amended power sales contract the project has been relocated to Telephone Flat and BPA has agreed to purchase 30 MW from the project with an option to purchase up to an additional 100 MW. The movement of the project to this alternative location and BPA's purchase obligation are subject to obtaining a final environmental impact statement relating to the new site location. Completion of this project is subject to a number of significant uncertainties and cannot be assured.

#### *6. Equity Investments*

At December 31, 1997, the Company had an indirect ownership of approximately 35% in the Casecan Project, a combined irrigation and 150 net MW hydroelectric power generation project located on the island of Luzon in the Philippines. The Company is expected to indirectly own approximately 70% of the Casecan Project after the KDG Acquisition.

The Company had an indirect ownership of 50% in the Mahanagdong Project, subject to a minority partner participation. The Company will indirectly own 100% of the Mahanagdong Project after the KDG Acquisition.



The Company has an approximate 45% economic interest in Saranac Power Partners, L.P. and a 20% economic interest in NorCon Power Partners, L.P. as part of the Falcon Seaboard acquisition.

Summary financial information for these equity investments follows:

	Casecanan	Saranac	NorCon	Mahanagdong
As of and for the year ended December 31, 1997:				
Assets	\$ 482,527	\$ 315,671	\$ 118,415	\$ 294,250
Liabilities	384,369	211,299	115,487	197,575
Net income				
(loss)	(11,267)	43,097	4,072	14,996
As of and for the year ended December 31, 1996:				
Assets	492,166	325,174	125,956	240,222
Liabilities	380,737	213,326	121,223	168,512
Net income				
(loss)	(11,207)	40,005	(53)	N/A

### 7. Parent Company Debt

Parent company debt comprises the following at December 31:

	1997	1996
Senior discount notes	\$ 529,640	\$ 527,535
9.5% senior notes	224,205	224,150
7.63% senior notes	350,000	—
Limited recourse senior secured notes*	200,000	200,000
CalEnergy credit facility	—	100,000
Revolving credit facility	—	95,000
	\$ 1,303,845	\$ 1,146,685

\*The amount of recourse obligation to the parent was \$0 at December 31, 1997.

#### Senior Discount Notes

In March 1994, the Company issued \$400,000 of 10 1/4% Senior Discount Notes which accrete to an aggregate principal amount of \$529,640 at maturity in 2004. The original issue discount was amortized from the issue date through January 15, 1997, during which time no cash interest was paid on the Senior Discount Notes. Cash interest on the Senior Discount Notes is payable semiannually on January 15 and July 15 of each year, commencing July 15, 1997.

The Senior Discount Notes are redeemable at any time on or after January 15, 1999 initially at a redemption price of 105.125% declining to 100% on January 15, 2002 plus accrued interest to the date of redemption. The Senior Discount Notes are unsecured senior obligations of the Company.

The Senior Discount Notes prohibit payment of cash dividends unless certain financial ratios are met and unless the dividends do not exceed 50% of the Company's accumulated adjusted consolidated net income as defined, subsequent to April 1, 1994, plus the proceeds of any stock issuance.

#### 9.5% Senior Notes

On September 20, 1996, the Company issued \$225,000 of 9.5% Senior Notes (the "9.5% Senior Notes") due 2006. Interest on the 9.5% Senior Notes is payable semiannually on March 15 and September 15 of each year, commencing March 15, 1997. The 9.5% Senior Notes are redeemable at any time on or after September 15, 2001 initially at a redemption price of 104.75% declining to 100% on September 15, 2004 plus accrued interest to the date of redemption. The 9.5% Senior Notes are unsecured senior obligations of the Company.

#### 7.63% Senior Notes

On October 28, 1997, the Company issued \$350,000 of 7.63% Senior Notes (the "7.63% Senior Notes") due 2007. Interest on the 7.63% Senior Notes will be payable semiannually on April 15 and October 15 of each year, commencing April 15, 1998. The 7.63% Senior Notes are unsecured senior obligations of the Company.

**Limited Recourse Senior Secured Notes**

On July 21, 1995, the Company issued \$200,000 of 9 7/8% Limited Recourse Senior Secured Notes Due 2003 (the "Notes"). Interest on the Notes is payable on June 30 and December 30 of each year, commencing December 1995. The Notes are secured by an assignment and pledge of 100% of the outstanding capital stock of Magma and are recourse only to such Magma capital stock, the Company's interest in a secured Magma note and general assets of the Company equal to the Restricted Payment Recourse Amount, as defined in the Note Indenture ("Note Indenture"), which was \$0 at December 31, 1997.

At any time or from time to time on or prior to June 30, 1998, the Company may, at its option, use all or a portion of the net cash proceeds of a Company equity offering (as defined in the Note Indenture) and shall at any time use all of the net cash proceeds of any Magma equity offering (as defined in the Note Indenture) to redeem up to an aggregate of 35% of the principal amount of the Notes originally issued at a redemption price equal to 109.875% of the principal amount thereof plus accrued interest to the redemption date. On or after June 30, 2000, the Notes are redeemable at the option of the Company, in whole or in part, initially at a redemption price of 104.9375% declining to 100% on June 30, 2002 and thereafter, plus accrued interest to the date of redemption.

**CalEnergy Credit Facility**

On October 28, 1996, the Company obtained a \$100,000 credit facility (the "CalEnergy Credit Facility") of which the Company had drawn \$100,000 as of December 31, 1996. The Company has repaid the entire balance of the CalEnergy Credit Facility.

**Revolving Credit Facility**

On July 8, 1996, the Company obtained a \$100,000 three year revolving credit facility. On November 26, 1997, the credit facility was amended and increased to \$400,000 and extended to November 2000. The facility is unsecured and is available to fund working capital requirements and finance future business expansion opportunities.

**Annual Repayments of Parent Company Debt**

There are no annual repayments of the parent company debt due for the next five years.

**8. Subsidiary and Project Debt:**

Project loans held by subsidiaries and projects which are non recourse to the Company comprise the following at December 31:

	1997	1996
Salton Sea Notes and Bonds	\$ 448,754	\$ 538,982
Northern eurobonds	427,732	439,192
U.K. credit facility	—	128,423
CE Electric UK Funding		
Company Senior Notes	357,331	—
CE Electric UK Funding		
Company Sterling Bonds	322,534	—
Power Resources project debt	103,334	114,571
Coso Funding Corp. project loans	106,616	148,346
Construction loans	416,744	300,951
Other	5,962	7,927
	\$ 2,189,007	\$ 1,678,392

Each of the Company's direct or indirect subsidiaries is organized as a legal entity separate and apart from the Company and its other subsidiaries. Pursuant to separate project financing agreements, the assets of each subsidiary are pledged or encumbered to support or otherwise provide the security for their own project or subsidiary debt. It should not be assumed that any asset of any such subsidiary will be available to satisfy the obligations of the Company or any of its other such subsidiaries; provided, however, that

unrestricted cash or other assets which are available for distribution may, subject to applicable law and the terms of financing arrangements of such parties, be advanced, loaned, paid as dividends or otherwise distributed or contributed to the Company or affiliates thereof. "Subsidiaries" means all

of CalEnergy's direct or indirect subsidiaries (1) owning interests in the Coso, Imperial Valley, Saranac, NorCon, Power Resources, Mahanagdong, Malitbog, Upper Mahiao, Casecan, Dieng and Patuha projects or (2) owning interests in the subsidiaries that own interests in the foregoing projects.

### *Salton Sea Notes and Bonds*

The Salton Sea Funding Corporation, a wholly owned subsidiary of the Company, (the "Funding Corporation") debt securities are as follows:

	Senior Secured Series	Final Maturity Date	Rate	December 31, 1997	December 31, 1996
July 21, 1995	A Notes	May 30, 2000	6.69%	\$ 97,354	\$ 161,732
July 21, 1995	B Bonds	May 30, 2005	7.37%	133,000	133,000
July 21, 1995	C Bonds	May 30, 2010	7.84%	109,250	109,250
June 20, 1996	D Notes	May 30, 2000	7.02%	44,150	70,000
June 20, 1996	E Bonds	May 30, 2011	8.30%	65,000	65,000
				\$ 448,754	\$ 538,982

Principal and interest payments are made in semi-annual installments. The Salton Sea Notes and Bonds are secured by the Company's four existing Salton Sea plants as well as an assignment of the right to receive various royalties payable to Magma in connection with its Imperial Valley properties and distributions from the Partnership Project. The Salton Sea Notes and Bonds are nonrecourse to the Company.

Pursuant to a depository agreement, Funding Corporation established a debt service reserve fund in the form of a letter of credit in the amount of \$70,430 from which scheduled interest and principal payments can be made.

### *Northern Eurobonds*

The Northern debt includes a debenture due in 1999, which bears a fixed interest rate of 12.661%. The debt also includes bearer bonds repayable in 2005 and 2020, bearing fixed interest rates of 8.625% and 8.875%, respectively.

The balance at December 31, 1997 and 1996 consists of the following:

	1997	1996
Debenture due 1999	\$ 97,530	\$ 99,924
Bearer bonds due 2005	165,236	171,130
Bearer bonds due 2020	164,966	168,138
	\$ 427,732	\$ 439,192

**U.K. Credit Facility**

On October 28, 1996, CE Holdings, an indirect subsidiary of the Company, obtained a £560,000 five year term loan and revolving credit facility (the "U.K. Credit Facility"). The Company did not guarantee, nor was it otherwise subject to recourse for, amounts borrowed under the U.K. Credit Facility. The agreement placed restrictions on distributions from CE Electric to any of its shareholders based on certain financial ratios. CE Electric has repaid the entire U.K. Credit Facility through the use of proceeds from the senior note and sterling bond offerings of CE Electric UK Funding Company described below.

**CE Electric UK Funding Company Senior Notes and Sterling Bonds**

On December 15, 1997, CE Electric UK Funding Company, an indirect subsidiary of the Company (the "Funding Company"), issued \$125,000 of 6.853% senior notes due 2004, and \$237,000 of 6.995% senior notes due 2007 (collectively, the "CE Electric UK Funding Company Senior Notes"), and £200,000 of 7.25% Sterling Bonds due

2022. The CE Electric UK Funding Company Senior Notes and Sterling Bonds prohibit distributions to any of its shareholders unless certain financial ratios are met by the Funding Company.

**Power Resources Project Financing Debt**

Power Resources, an indirect wholly-owned subsidiary, has project financing debt consisting of a term loan payable to a consortium of banks with interest and principal due quarterly through October 2003. The debt carries fixed interest rates of 10.385% and 10.625%.

**Coso Funding Corp. Project Loans**

The Coso Funding Corp. project loans are from Coso Funding Corp., a single-purpose corporation formed to issue notes for its own account and act as an agent on behalf of the Coso Project. The Coso Funding Corp. project loans carry a fixed interest rate with weighted average interest rates of 8.65% and 8.46% at December 31, 1997 and 1996, respectively. The loans have scheduled repayments through December 2001. The Coso Project has established irrevocable letters of credit of \$67,850 as a debt service reserve fund.

**Annual Repayments of Subsidiary and Project Debt**

The annual repayments of the subsidiary and project debt, excluding construction loans, for the years beginning January 1, 1998 and thereafter are as follows:

	CE Electric UK Funding Company						
	Salton Sea Notes and Bonds	Northern Eurobonds	Senior Notes and Sterling Bonds	Power Resources	Coso Funding Corp.	Other	Total
1998	\$ 106,938	\$ —	\$ —	\$ 12,805	\$ 38,912	\$ 1,544	\$ 160,199
1999	57,836	97,530	—	14,268	31,717	1,297	202,648
2000	25,072	—	—	16,087	4,080	1,051	46,290
2001	22,376	—	—	18,119	31,907	838	73,240
2002	24,298	—	—	20,312	—	1,232	45,842
Thereafter	212,234	330,202	679,865	21,743	—	—	1,244,044
	\$ 448,754	\$ 427,732	\$ 679,865	\$ 103,334	\$ 106,616	\$ 5,962	\$ 1,772,263

### *Construction Loans*

The Company's allocable share of non-recourse project construction loans comprise the following at December 31:

	1997	1996
Upper Mahiao	\$ 150,628	\$ 150,628
Malitbog	176,657	137,881
CE Indonesia Funding Corp.	89,459	12,442
	\$ 416,744	\$ 300,951

The Upper Mahiao and Malitbog construction loans are scheduled to be replaced by non-recourse term project financing upon completion of construction and commencement of commercial operations.

#### *Upper Mahiao Construction Loan*

Draws on the construction loan for the Upper Mahiao geothermal power project at December 31, 1997 totaled \$150,628. A consortium of international banks provided the construction financing with variable interest rates based on LIBOR or "Prime" with interest payments due every quarter and at LIBOR maturity. The weighted average interest rate at December 31, 1997 and 1996 is approximately 8.43% and 8.01%, respectively. The Export-Import Bank of the U.S. ("Ex-Im Bank") is providing political risk insurance to commercial banks on the construction loan. The construction loan is expected to be converted to a term loan promptly after NPC completes the full capacity transmission line, which is currently expected in 1998. The largest portion of the term loan for the project will also be provided by Ex-Im Bank. The term financing for the Ex-Im Bank loan will be at a fixed interest rate of 5.95%.

#### *Malitbog Construction Loan*

Draws on the construction loan for the Malitbog geothermal power project at December 31, 1997 totaled \$176,657. International banks and the Overseas Private Investment Corporation ("OPIC")

have provided the construction and term loan facilities at variable interest rates (weighted average of 8.48% and 8.15% at December 31, 1997 and 1996, respectively). The international bank portion of the debt will be insured by OPIC against political risks and the Company's equity contribution to Visayas Geothermal Power Company ("VGPC") is covered by political risk insurance from the Multilateral Investment Guarantee Agency and OPIC. The construction loan is expected to be converted to a term loan promptly after NPC completes the full capacity transmission line, which is currently expected in 1998.

#### *CE Indonesia Funding Corp.*

In June 1997, the Company's indirect special-purpose subsidiary, CE Indonesia Funding Corp., entered into a \$400,000 revolving credit facility (which is nonrecourse to the Company) to finance the development and construction of the Company's geothermal power facilities in Indonesia. This credit facility was used in part to replace the original project financing for Himpurna California Energy's Dieng Unit I. At December 31, 1997, the Company's share of the credit facility relating to Dieng Unit I was \$50,481 and carried a variable interest rate (weighted average of 7.44% at December 31, 1997).

On November 18, 1997, Himpurna California Energy announced the funding of the Dieng Unit II project pursuant to the CE Indonesia Funding Corp. facility arranged in June 1997. At December 31, 1997, the Company's share of the credit facility relating to Dieng Unit II was \$11,211 and carried a variable interest rate (weighted average of 7.48% at December 31, 1997).

On September 2, 1997, Patuha Power announced the funding of the Patuha Unit I project pursuant to the CE Indonesia Funding Corp. facility arranged in June 1997.

At December 31, 1997, the Company's share of the credit facility relating to Patuha was \$27,767 and carried a variable interest rate (weighted average of 7.44% at December 31, 1997).

### 9. Income Taxes

Provision for income taxes is comprised of the following at December 31:

	1997	1996	1995
<b>Currently payable:</b>			
State	\$ 5,084	\$ 7,520	\$ 5,510
Federal	33,114	19,873	11,138
Foreign	5,262	2,176	—
	43,460	29,569	16,648
<b>Deferred:</b>			
State	(264)	1,619	921
Federal	14,579	9,209	13,062
Foreign	41,269	1,424	—
	55,584	12,252	13,983
<b>Total</b>	<b>\$ 99,044</b>	<b>\$ 41,821</b>	<b>\$ 30,631</b>

A reconciliation of the federal statutory tax rate to the effective tax rate applicable to income before provision for income taxes follows:

	1997	1996	1995
Federal statutory rate	35.00%	35.00%	35.00%
Percentage depletion in excess of cost depletion	(3.77)	(6.12)	(7.38)
Investment and energy tax credits	(.64)	(8.34)	(1.80)
State taxes, net of federal tax effect	1.59	4.38	4.09
Goodwill amortization	2.06	2.51	2.53
Non-deductible expense	1.33	.84	1.10
Lease investment	—	—	(2.18)
Dividends on convertible preferred securities of subsidiary trusts*	(4.12)	(1.17)	—
Tax effect of foreign income	2.64	2.54	—
Asset valuation impairment	15.47	—	—
Other	.75	.15	.20
<b>Effective tax rate</b>	<b>50.31%</b>	<b>29.79%</b>	<b>31.56%</b>

\* Dividends on convertible preferred securities of subsidiary trusts are included in minority interest.

Deferred tax liabilities (assets) are comprised of the following at December 31:

	1997	1996
Depreciation and amortization, net	\$ 802,215	\$ 725,366
Pensions	19,441	22,883
Unremitted foreign earnings	10,781	2,857
Other	3,324	3,262
	835,761	754,368
Deferred contract costs	(193,996)	(128,745)
Deferred income	(12,690)	(9,298)
Energy and investment tax credits	(42,049)	(55,931)
Advance corporation tax	—	(20,205)
Alternative minimum tax credits	(39,402)	(50,819)
Accruals not currently deductible for tax purposes	(31,561)	(13,372)
Other	(7,004)	(6,799)
	(326,702)	(285,169)
<b>Net deferred taxes</b>	<b>\$ 509,059</b>	<b>\$ 469,199</b>

The Company has unused investment and geothermal energy tax credit carryforwards of approximately \$42,049 expiring between 2004 and 2012. The Company also has approximately \$39,402 of alternative minimum tax credit carryforwards which have no expiration date.

### 10. *Company-Obligated Mandatorily Redeemable Convertible Preferred Securities of Subsidiary Trusts*

The Company has organized special purpose Delaware business trusts ("Trust I", "Trust II" and "Trust III" or collectively, the "Trusts") pursuant to their respective amended and

restated declarations of trusts (collectively, the "Declarations"). On April 12, 1996, February 26, 1997 and August 12, 1997, the Company, through these Trusts, issued Company-obligated mandatorily redeemable convertible preferred securities (collectively, the "Trust Securities") as follows:

Issuer	Issue Date	Rate	Amount	Conversion Rate
CalEnergy Capital Trust I	April 12, 1996	6.25%	\$ 103,930	1.6728
CalEnergy Capital Trust II	February 26, 1997	6.25%	\$ 180,000	1.1655
CalEnergy Capital Trust III	August 12, 1997	6.50%	\$ 270,000	1.047

The Company owns all of the common securities of the Trusts. The Trust Securities have a liquidation preference of fifty dollars each and represent undivided beneficial ownership interests in each of the Trusts. The assets of the Trusts consist solely of the Company's Convertible Subordinated Debentures due March 10, 2016, February 25, 2012 and September 1, 2027, respectively, in outstanding aggregate principal amounts of \$103,930, \$180,000 and \$270,000, respectively (collectively, the "Junior Debentures") issued pursuant to their respective indentures. The indentures include agreements by the Company to pay expenses and obligations incurred by the Trusts. Each Trust Security with a par value of \$50 is convertible at the option of the holder at any time into shares of CalEnergy Common Stock based on the conversion rate and subject to customary anti-dilution adjustments.

Until converted into the Company's Common Stock, the Trust Securities will have no voting rights with respect to the Company and, except under certain limited circumstances, will have no voting rights with respect to the Trusts. Distributions on the Trust Securities (and Junior Debentures) are cumulative,

accrue from the date of initial issuance and are payable quarterly in arrears. The Junior Debentures are subordinated in right of payment to all senior indebtedness of the Company and the Junior Debentures are subject to certain covenants, events of default and optional and mandatory redemption provisions, all as described in the Junior Debenture indentures.

Pursuant to Preferred Securities Guarantee Agreements (collectively, the "Guarantees"), between the Company and a preferred guarantee trustee, the Company has agreed irrevocably to pay to the holders of the Trust Securities, to the extent that the Trustee has funds available to make such payments, quarterly distributions, redemption payments and liquidation payments on the Trust Securities. Considered together, the undertakings contained in the Declarations, Junior Debentures, Indentures and Guarantees constitute full and unconditional guarantees by the Company of the Trusts' obligations under the Trust Securities.

### ***11. Preferred Stock***

On December 1, 1988, the Company distributed a dividend of one preferred share purchase right ("right") for each outstanding share of common stock. The rights are not exercisable until ten days after a person or group acquires or has the right to acquire, beneficial ownership of 20% or more of the Company's common stock or announces a tender or exchange offer for 30% or more of the Company's common stock. Each right entitles the holder to purchase one one-hundredth of a share of Series A junior preferred stock for \$52. The rights may be redeemed by the Board of Directors up to ten days after an event triggering the distribution of certificates for the rights. The rights will expire, unless previously redeemed or exercised, on November 30, 1998. The rights are automatically attached to, and trade with, each share of common stock.

### ***12. Stock Options and Restricted Stock***

The Company has issued various stock options. As of December 31, 1997, a total of 6,949 shares are reserved for stock options, of which 6,780 shares have been granted and remain outstanding at prices of \$3.74 to \$40.81 per share.

The Company has stock option plans under which shares were reserved for grant as incentive or non-qualified stock options, as determined by the Board of Directors. The plans allow options to be granted at 85% of their fair market value at the date of grant. Generally, options are issued at 100% of fair market value at the date of grant. Options granted under the 1996 Plan become exercisable over a period of two to five years and expire if not exercised within ten years

from the date of grant or, in some instances, a lesser term. Prior to the 1996 Plan, the Company granted 256 options at fair market value at date of grant which had terms of ten years and were exercisable at date of grant. In addition, the Company had issued approximately 138 options to consultants on terms similar to those issued under the 1996 Plan. The non-1996 plan options are primarily options granted to Kiewit.

The Company granted 500 shares of restricted common stock with an aggregate market value of \$9,500 in exchange for the relinquishment of 500 stock options which were canceled by the Company. The shares have all rights of a shareholder, subject to certain restrictions on transferability and risk of forfeiture. Unearned compensation equivalent to the market value of the shares at the date of issuance was charged to stockholders' equity. Such unearned compensation was amortized over the vesting period of which 125 shares were immediately vested and the remaining 375 shares vested through January 1, 1998. Accordingly, \$5,471, \$1,535 and \$2,494 of unearned compensation was charged to general and administrative expense in 1997, 1996 and 1995 respectively.



*Transactions in Stock Options*

	Options Outstanding				
	Shares Available for Grant Under 1996 Option Plan	Shares	Option Price Per Shares	Weighted Avg Option Price	Total
Balance December 31, 1994	86	9,601	\$ 3.00 - \$ 19.00	\$ 12.84	\$ 123,277
Options granted	(396)	396	15.81 - 19.00	18.15	7,188
Options terminated	571	(571)	14.88 - 19.00	18.69	(10,673)
Options exercised	—	(135)	3.00 - 15.94	3.41	(460)
Balance December 31, 1995	261	9,291	3.00 - 19.00	12.84	119,332
Options granted	(1,157)	1,157	25.06 - 30.38	28.17	32,590
Options terminated	468	(468)	3.00 - 19.00	17.96	(8,406)
Options exercised	—	(5,203)	3.00 - 21.68	11.13	(57,931)
Additional shares reserved under 1996 Option Plan	739	—	—	—	—
Balance December 31, 1996	311	4,777	3.00 - 30.38	17.92	85,585
Options granted	(2,307)	2,513	29.06 - 40.81	34.80	87,457
Options terminated	165	(165)	3.00 - 29.06	20.04	(3,307)
Options exercised	—	(345)	3.74 - 29.06	13.28	(4,583)
Additional shares reserved under 1996 Option Plan	2,000	—	—	—	—
Balance December 31, 1997	169	6,780	\$ 3.74 - \$ 40.81	\$ 24.36	\$ 165,152
Options exercisable at:					
December 31, 1995		8,229	\$ 3.00 - \$ 19.00	\$ 12.26	\$ 100,886
December 31, 1996		3,071	\$ 3.00 - \$ 30.38	\$ 14.25	\$ 43,770
December 31, 1997		3,665	\$ 3.74 - \$ 40.19	\$ 18.12	\$ 66,425

The following table summarizes information about stock options outstanding and exercisable as of December 31, 1997:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Exercise Price
\$ 3.74 - \$ 11.99	1,161	\$ 11.22	3 years	1,161	\$ 11.22
12.00 - 21.99	2,020	16.90	6 years	1,739	16.82
22.00 - 31.99	1,092	28.10	8 years	311	28.25
32.00 - 40.81	2,507	34.83	9 years	454	34.12
	6,780	\$ 24.36	7 years	3,665	\$ 18.12

The Company applies the intrinsic value based method of accounting for its stock-based employee compensation plans. If the fair value based method had been applied for 1997, non-cash compensation expense and the effect on net income available to common stockholders and earnings per share would have been approximately \$3,600, or \$0.05 per share. If the fair value based method had been applied for 1996 and 1995, non-cash compensation expense and the effect on net income available to common stockholders and earnings per share would have been immaterial. The fair value for stock options was estimated using the Black-Scholes option pricing model with assumptions for the risk-free interest rate of 5.50% in 1997 and 6.00% in 1996 and 1995, expected volatility of 25% in 1997 and 22% in 1996 and 1995, expected life of approximately 3.7 years in 1997 and 4.5 years in 1996 and 1995, and no expected dividends. The weighted average fair value of options granted during 1997, 1996 and 1995 was \$9.55, \$8.62 and \$5.72 per option, respectively.

### *13. Common Stock Sales & Related Options*

On October 17, 1997, the Company completed the public offering of 17,100 shares of its common stock ("Common Stock") at \$37 7/8 per share (the "Public Offering"). In addition, 2,000 shares of Common Stock were purchased from CalEnergy in a direct sale by a trust affiliated with Walter Scott, Jr., the Chairman and Chief Executive Officer of PKS (the "Direct Sale"), contemporaneously with the closing of the Public Offering. Proceeds from the Public Offering and the Direct Sale were approximately \$699,920.

Simultaneous with the acquisition of the remaining equity interest of Magma on February 24, 1995, the Company completed a public offering (the "Offering") of 18,170 shares of common stock, which amount included a direct sale by the Company to Kiewit of 1,500 shares and the exercise of underwriter over-allotment options for 1,500 shares, at a price of \$17.00 per share. The Company received proceeds of \$300,388 from the Offering.

### *14. Asset Valuation Impairment Charge*

The non-recurring charge of \$87,000 represents an asset valuation impairment charge under Financial Accounting Standard No. 121, "Accounting for the Impairment of Long-Lived Assets," relating to CalEnergy's assets in Indonesia. Moreover, the Company intends to continue to take actions to attempt to require the government of Indonesia to honor its contractual obligations; however, the ultimate outcome of the current uncertain situation in Indonesia with respect to the possible abrogation by the Indonesian government of the Dieng, Patuha and Bali contracts adds significant risk to the completion of those projects. Consequently, the charge of \$87,000 represents the amount by which the carrying amount of such assets exceed the fair value of the assets determined by discounting the expected future net cash flows of the Indonesia projects, assuming proceeds from political risk insurance and no tax benefits.

### 15. Extraordinary Item

On July 31, 1997, the Finance Act in the United Kingdom was passed by Parliament and included the introduction of a one time so-called "windfall tax" equal to 23% of the difference between the price paid for Northern upon privatization and the Labour government's assessed "value" of Northern as calculated by reference to a formula set forth in the July budget. This amounted to \$135,850, net of minority interest of \$58,222, which was recorded as an extraordinary item. The first installment was paid December 1, 1997 and the second installment is payable on December 1, 1998.

### 16. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between

willing parties, other than in a forced sale or liquidation. Although management uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique. Therefore, the fair value estimates presented herein are not necessarily indicative of the amounts which the Company could realize in a current transaction.

The methods and assumptions used to estimate fair value are as follows:

Debt instruments—The fair value of all debt issues listed on exchanges has been estimated based on the quoted market prices.

Other financial instruments—All other financial instruments of a material nature fall into the definition of short-term and fair value is estimated as the carrying amount.

The carrying amounts in the table below are included under the indicated captions in Notes 7, 8 and 10.

	1997		1996	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Senior discount notes	\$ 529,640	\$ 569,148	\$ 527,535	\$ 556,971
9.5% Senior notes	224,205	243,615	224,150	229,866
7.63% Senior notes	350,000	352,857	—	—
Limited recourse senior secured notes	200,000	217,829	200,000	212,560
CalEnergy credit facility	—	—	100,000	100,000
Revolving line of credit	—	—	95,000	95,000
Salton Sea notes and bonds	448,754	463,720	538,982	531,807
Northern eurobonds	427,732	482,064	439,192	445,830
Construction loans	416,744	416,744	300,951	300,951
Coso Funding Corp. project loans	106,616	112,932	148,346	153,650
CE Electric UK Funding Company Senior Notes	357,331	357,331	—	—
CE Electric UK Funding Company Sterling Bonds	322,534	333,257	—	—
Power Resources project debt	103,334	103,334	114,571	114,571
U.K. credit facility	—	—	128,423	128,423
Other	5,962	5,962	7,927	7,927
Convertible preferred securities of subsidiary trusts	553,930	514,373	103,930	128,354

### **17. Interest Rate Swap Agreements**

On December 15, 1997, CE Electric UK Funding Company entered into certain interest rate swap agreements for the CE Electric UK Funding Company Senior Notes with two large multi-national financial institutions. The swap agreements effectively convert the U.S. dollar fixed interest rate to a fixed rate in Sterling. For the \$125,000 of 6.853% senior notes, the agreements extend until December 30, 2004 and convert the U.S. dollar interest rate to a fixed Sterling rate of 7.744%. For the \$237,000 of 6.995% senior notes, the agreements extend until December 30, 2007 and convert the U.S. dollar interest rate to a fixed Sterling rate of 7.737%. The estimated fair value of these swap agreements is approximately \$4,929 based on quotes from the counter party to these instruments and represents the estimated amount that the Company would expect to pay to terminate these agreements. It is the Company's intention to hold the swap agreements to their intended maturity.

### **18. Regulatory Matters**

Northern is subject to price cap regulation. Price control formulas for the supply and distribution businesses are enforced by the Office of Electricity Regulation ("OFFER").

In the distribution business the current price control is expected to last until 2000. The formula was reviewed with effect from April 1, 1995 and April 1, 1996 which resulted in one-time reductions in allowed income per unit distributed of about 17% and 13% respectively, with continuing real reductions in each of the subsequent three years 1997/98 to 1999/2000. The current formula requires that each year regulated distribution income per unit is increased or decreased by RPI-Xd where RPI reflects the average of the twelve month inflation rates recorded for the

previous July to December period and Xd is set at 3%. The formula also takes account of the changes in system electrical losses, the number of customers connected and the voltage at which customers receive the units of electricity distributed.

In the supply business the current formula applies only to customers with demands below 100kW. Under the current formula the purchase cost of electricity and the cost of transmission, distribution and the fossil fuel levy are passed through to customers in full. That part of the formula governing Northern's own supply business costs requires that this element of the permitted income falls by 2% per annum in real terms. The current formula is due to be replaced from April 1, 1998 with a new formula which will require Northern to reduce prices to those customers protected by the new price control from the level prevailing at August 1, 1997 by about 4.2% (minus inflation) with effect from April 1, 1998 and a further 3% (minus inflation) with effect from April 1, 1999.

The market for electricity supplied to customers with demands over 1MW was opened to competition in 1990. In 1994 this limit was reduced to 0.1MW. In 1998, liberalization of the entire market is due to commence in stages with complete liberalization achieved by June 1999.

### **19. Pension Commitments**

Northern participates in the Electricity Supply Pension Scheme, which provides pension and other related defined benefits, based on final pensionable pay, to substantially all employees throughout the Electricity Supply Industry in the United Kingdom.

The actuarial computation for December 31, 1997 and 1996 assumed interest rates of 6.75% and 7.75%, respectively, an expected return on plan assets of 7.25% and 8.25%, respectively, and annual compensation increases of 4.75% and 5.75%, respectively, over the remaining service lives of employees covered under the plan. Amounts funded to the pension are primarily invested in equity and fixed income securities. Northern's funding policy for the plan is to contribute annually at a rate that is intended to remain a level percentage of compensation for the covered employees.

The following table details the funded status and the amount recognized in the balance sheet of the Company as of December 31, 1997 and 1996.

Actuarial present value of benefit obligations:

	1997	1996
Vested benefits	\$ 847,694	\$ 797,932
Nonvested benefits	—	—
Accumulated benefit obligation	847,694	797,932
Effect of future increase in compensation	40,898	58,218
Projected benefit obligation	888,592	856,150
Fair value of plan assets	1,012,601	919,163
Assets in excess of projected benefit obligation	124,009	63,013
Unrecognized net gain	61,265	—
Prepaid pension asset	\$ 62,744	\$ 63,013

Net periodic pension cost for 1997 included the following components (the components for the period from the acquisition date of Northern to December 31, 1996 are not meaningful):

Service cost—benefits earned during the period	\$ 12,600
Interest cost on projected benefit obligation	62,300
Actual return on plan assets	(71,300)
Net periodic pension cost	\$ 3,600

## 20. Commitments and Contingencies

### Casecnan

In November 1995, the Company closed the financing and commenced construction of the Casecnan Project, a combined irrigation and 150 net MW hydroelectric power generation project (the "Casecnan Project") located in the central part of the island of Luzon in the Republic of the Philippines.

CE Casecnan Water and Energy Company, Inc., a Philippine Corporation ("CE Casecnan") which is expected to be approximately 70% indirectly owned by the Company (after the KDG Acquisition), is developing the Casecnan Project. CE Casecnan financed a portion of the costs of the Casecnan Project through the issuance of \$125,000 of its 11.45% Senior Secured Series A Notes due 2005 and \$171,500 of its 11.95% Senior Secured Series B Bonds due 2010 and \$75,000 of its Secured Floating Rate Notes due 2002, pursuant to an indenture dated as of November 27, 1995, as amended to date.

The Casecnan Project was being constructed pursuant to a fixed-price, date-certain, turnkey construction contract (the "Hanbo Contract") on a joint and several basis by Hanbo Corporation ("Hanbo") and Hanbo Engineering and Construction Co., Ltd. ("HECC"), both of which are South Korean corporations. As of May 7, 1997, CE Casecnan terminated the Hanbo Contract due to defaults by Hanbo and HECC including the insolvency of each such company. On May 7, 1997 CE Casecnan entered into a new turnkey engineering, procurement and construction contract to complete the construction of the Casecnan Project (the "Replacement Contract"). The work under the Replacement Contract is being conducted by a consortium consisting

of Cooperativa Muratori Cementisti CMC di Ravenna and Impresa Pizzarottie & C. Spa working together with Siemens A.G., Sulzer Hydro Ltd., Black & Veatch and Colenco Power Engineering Ltd. (collectively, the "Replacement Contractor").

In connection with the Hanbo Contract termination, CE Casecnan tendered a certificate of drawing to Korea First Bank ("KFB") on May 7, 1997 under the irrevocable standby letter of credit issued by KFB as security under the Hanbo Contract to pay for certain transition costs and other presently ascertainable damages under the Hanbo Contract. As a result of KFB's wrongful dishonor of the draw request, CE Casecnan filed an action in New York State Court. That Court granted CE Casecnan's request for a temporary restraining order requiring KFB to deposit \$79,329, the amount of the requested draw, in an interest bearing account with an independent financial institution in the United States. KFB appealed this order, but the appellate court denied KFB's appeal and on May 19, 1997, KFB transferred funds in the amount of \$79,329 to a segregated New York bank account pursuant to the Court order.

On August 6, 1997, CE Casecnan announced that it had issued a notice to proceed to the Replacement Contractor. The Replacement Contractor was already on site and thereafter fully mobilized and commenced engineering, procurement and construction work on the Casecnan Project.

On August 27, 1997, CE Casecnan announced that it had received a favorable summary judgment ruling in New York State Court against KFB. The judgment, which has been appealed by the bank, requires KFB to honor the \$79,329 drawing by CE Casecnan on the \$117,850 irrevocable standby letter of credit.

On September 29, 1997, CE Casecnan tendered a second certificate of drawing for \$10,828 to KFB and on December 30, 1997, CE Casecnan tendered a third certificate of drawing for \$2,920 to KFB. KFB also wrongfully dishonored these draws, but pursuant to a stipulation agreed to deposit the draw amounts in an interest bearing account with the same independent financial institution in the United States pending resolution of the appeal regarding the first draw and agreed to expedite the appeal.

The receipt of the letter of credit funds from KFB remains essential and CE Casecnan will continue to press KFB to honor its clear obligations under the letter of credit and to pursue Hanbo and KFB for any additional damages arising out of their actions to date. If KFB were to fail to honor its obligations under the Casecnan letter of credit, such action could have a material adverse effect on the Casecnan Project and CE Casecnan.

On September 2, 1997, Hanbo and HECC filed a Request for Arbitration before the International Chamber of Commerce ("ICC"). The Request for Arbitration asserts various claims by Hanbo and HECC against CE Casecnan relating to the terminated Hanbo Contract and seeking damages. On October 10, 1997, CE Casecnan served its answer and defenses in response to the Request for Arbitration as well as counterclaims against Hanbo and HECC for breaches of the Hanbo Contract. The arbitration proceedings before the ICC are ongoing and CE Casecnan intends to pursue vigorously its claims against Hanbo, HECC and KFB in the proceedings described above.

### *Indonesia*

On September 20, 1997, a Presidential Decree (the "Decree") was issued in Indonesia, providing for government action to the effect that, in order to address certain recent fluctuations in the value of the Indonesian currency, the start-up dates for a number of private power projects would be: (i) continued according to their initial schedule (because construction was underway); (ii) postponed as to their start-up dates (because they are not yet in construction) until economic conditions have recovered; or (iii) reviewed with a view to being continued, postponed or rescheduled, depending on the status of those projects. In the Decree, Dieng Units 1, 2 and 3 are approved to continue according to their initial schedule; Patuha Unit 1 and Bali Units 1 and 2 are to receive further review to determine whether or not they should be continued in accordance with their initial schedule; and Bali Units 3 and 4, Patuha Units 2, 3 and 4 and Dieng Unit 4 are to be postponed for an unspecified period. In this regard, the Company notes that its contracts and government undertakings for the Dieng, Patuha and Bali projects do not by their terms permit such categorization or delays by the government and that the Company has obtained political risk insurance coverage for its Dieng and Patuha projects. Moreover, the Company intends to continue to take actions to attempt to require the Government of Indonesia to honor its contractual obligations; however, subsequent actions by the Government of Indonesia and continued economic problems in Indonesia have created further uncertainty as to whether the contracts for such projects will be abrogated by the Indonesian government and accordingly have created significant risks to the completion

of these projects. As a result, the Company recorded a SFAS 121 asset valuation impairment charge of \$87,000 in the fourth quarter of 1997. This charge includes all reasonably estimated asset valuation impairments associated with the Company's assets in Indonesia and gives effect to the political risk insurance on such investments.

### *Edison*

On June 9, 1997, Edison filed a complaint alleging breach of the power purchase agreements ("SO4 Agreements") between Edison and the Coso Joint Ventures as a result of alleged improper venting of certain noncondensable gases at the Coso geothermal energy project. In the complaint Edison seeks unspecified damages, including the refund of certain amounts previously paid under the SO4 Agreements, and termination of the SO4 Agreements. In September 1997, the Coso Joint Ventures and the Company filed a cross-complaint against Edison and its affiliates, The Mission Group and Mission Power Engineering Company alleging, among other things, that Edison's lawsuit violates the 1993 settlement agreement which settled certain litigation arising from the construction of certain units at the Coso geothermal project by Edison affiliates. In addition, the Coso Joint Ventures filed a separate complaint against Edison alleging breach of the SO4 Agreements, unfair business practices, slander and various other tort and contract claims. The actions were effectively consolidated in December 1997. As a result of certain procedural actions by the parties and a November court order, Edison filed an amended complaint on December 16, 1997 and the Coso Joint Ventures amended their cross-complaint. The litigation is in its early procedural stages and the pleadings

have not been settled. The Coso Joint Ventures believe that their claims and defenses are meritorious and that they will prevail if the matter is ultimately heard on its merits. The Coso Joint Ventures intend to vigorously defend this action and prosecute all available counterclaims against Edison.

#### NYSEG

On February 14, 1995, NYSEG filed with the FERC a Petition for a Declaratory Order, Complaint, and Request for Modification of Rates in Power Purchase Agreements Imposed Pursuant to the Public Utility Regulatory Policies Act of 1978 ("Petition") seeking FERC (i) to declare that the rates NYSEG pays under the Saranac PPA, which was approved by the New York Public Service Commission (the "PSC") were in excess of the level permitted under PURPA and (ii) to authorize the PSC to reform the Saranac PPA. On March 14, 1995, the Saranac Partnership intervened in opposition to the Petition asserting, *inter alia*, that the Saranac PPA fully complied with PURPA, that NYSEG's action was untimely and that the FERC lacked authority to modify the Saranac PPA. On March 15, 1995, the Company intervened also in opposition to the Petition and asserted similar arguments. On April 12, 1995, the FERC by a unanimous (5-0) decision issued an order denying the various forms of relief requested by NYSEG and finding that the rates required under the Saranac PPA were consistent with PURPA and the FERC's regulations. On May 11, 1995, NYSEG requested rehearing of the order and, by order issued July 19, 1995, the FERC unanimously (5-0) denied NYSEG's request. On June 14, 1995, NYSEG petitioned the United States Court of Appeals for the District of Columbia Circuit (the "Court of Appeals") for review of FERC's April 12, 1995 order. FERC moved to dismiss NYSEG's petition for

review on July 28, 1995. On October 30, 1996, all parties filed final briefs and the Court of Appeals heard oral arguments on December 2, 1996. On July 11, 1997, the Court of Appeals dismissed NYSEG's appeal from FERC's denial of the petition on jurisdictional grounds.

On August 7, 1997, NYSEG filed a complaint in the U.S. District Court for the Northern District of New York against the FERC, the PSC (and the Chairman, Deputy Chairman and the Commissioners of the PSC as individuals in their official capacity), the Saranac Partnership and Lockport Energy Associates, L.P. ("Lockport") concerning the power purchase agreements that NYSEG entered into with Saranac Partners and Lockport.

NYSEG's suit asserts that the PSC and the FERC improperly implemented PURPA in authorizing the pricing terms that NYSEG, the Saranac Partnership and Lockport agreed to in those contracts. The action raises similar legal arguments to those rejected by the FERC in its April and July 1995 orders. NYSEG in addition asks for retroactive reformation of the contracts as of the date of commercial operation and seeks a refund of \$281 million from the Saranac Partnership. Saranac and other parties have filed motions to dismiss and oral arguments on those motions were heard on March 2, 1998. Saranac believes that NYSEG's claims are without merit for the same reasons described in the FERC's orders.



**Leases**

Certain retail facilities, buildings and equipment are leased. The leases expire in periods ranging from one to 75 years and some provide for renewal options.

At December 31, 1997, the Company's future minimum rental payments with respect to non-cancelable operating leases were as follows:

1998	\$ 5,321
1999	4,970
2000	4,914
2001	4,742
2002	4,643
Thereafter	53,905
	<u>\$ 78,495</u>

**21. Geographic Information**

The Company operates in one principal industry segment: the generation, distribution and supply of electricity to customers located throughout the world. Europe consists primarily of Northern. The Company's operations by geographic area are as follows:

	1997	1996	1995
<b>Revenue</b>			
Americas	\$ 570,587	\$ 486,189	\$ 386,833
Asia	102,960	33,282	—
Europe	1,566,442	39,191	—
Corporate/Other	30,922	17,533	11,890
	<u>\$ 2,270,911</u>	<u>\$ 576,195</u>	<u>\$ 398,723</u>
<b>Operating income *</b>			
Americas	\$ 301,589	\$ 259,665	\$ 209,872
Asia	61,131	16,766	—
Europe	191,299	6,163	—
Corporate/Other	(12,882)	(10,931)	(10,376)
	<u>\$ 541,137</u>	<u>\$ 271,663</u>	<u>\$ 199,496</u>

\* Operating income excludes the loss on equity investment in Cascanan, net interest expense and the non-recurring charge.

	1997	1996
<b>Identifiable assets</b>		
Americas	\$ 2,268,629	\$ 2,364,448
Asia	835,616	649,053
Europe	2,937,686	2,384,789
Corporate/Other	1,445,695	231,866
	<u>\$ 7,487,626</u>	<u>\$ 5,630,156</u>

## 22. Quarterly Financial Data (Unaudited)

Following is a summary of the Company's quarterly results of operations for the years ended December 31, 1997 and 1996.

1997: <sup>(1)</sup>	Three Months Ended *			
	March 31	June 30	September 30	December 31
Operating revenue	\$ 542,589	\$ 505,922	\$ 527,896	\$ 589,931
Total revenue	565,976	524,994	551,893	628,048
Total costs and expenses	506,104	460,184	467,900	639,863
Income (loss) before income taxes	59,872	64,810	83,993	(11,815)
Provision for income taxes	22,249	24,342	27,929	24,524
Income (loss) before minority interest	37,623	40,468	56,064	(36,339)
Minority interest	10,175	9,579	9,656	16,583
Income (loss) before extraordinary item	27,448	30,889	46,408	(52,922)
Extraordinary item	—	—	(135,850)	—
Income (loss) attributable to common stockholders	27,448	30,889	(89,442)	(52,922)
Income (loss) per share before extraordinary item	\$ .43	\$ .49	\$ .73	\$ (.67)
Extraordinary item	—	—	(2.14)	—
Net income (loss) per share	\$ .43	\$ .49	\$ (1.41)	\$ (.67)
Income (loss) per share before extraordinary item—diluted	\$ .42	\$ .46	\$ .67	\$ (.67)
Extraordinary item—diluted	—	—	(1.80)	—
Net income (loss) per share—diluted	\$ .42	\$ .46	\$ (1.13)	\$ (.67)

1996: <sup>(1)</sup>	Three Months Ended *			
	March 31	June 30	September 30	December 31
Operating revenue	\$ 75,944	\$ 104,735	\$ 165,487	\$ 172,768
Total revenue	90,356	115,794	179,048	190,997
Total costs and expenses	69,398	86,039	121,545	158,809
Income before income taxes	20,958	29,755	57,503	32,188
Provision for income taxes	6,497	9,040	18,325	7,959
Income before minority interest	14,461	20,715	39,178	24,229
Minority interest	—	1,443	1,624	3,055
Net income attributable to common stockholders	\$ 14,461	\$ 19,272	\$ 37,554	\$ 21,174
Net income per share	\$ .28	\$ .37	\$ .71	\$ .34
Net income per share—diluted	\$ .27	\$ .34	\$ .61	\$ .33

\* The Company's operations are seasonal in nature.

(1) Reflects acquisitions of Northern, Falcon Seaboard and the Partnership Interest.

# Independent Auditors' Report

*Board of Directors and Shareholders  
CalEnergy Company, Inc.  
Omaha, Nebraska*

We have audited the accompanying consolidated balance sheets of CalEnergy Company, Inc. and subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of CalEnergy Company, Inc. and subsidiaries at December 31, 1997 and 1996 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

*Deloitte & Touche LLP*

*Deloitte & Touche LLP  
Omaha, Nebraska  
February 12, 1998*

# Corporate Information

## CORPORATE HEADQUARTERS

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302 S. 36th Street, Suite 400  
Omaha, NE 68131-3845  
Telephone: 402-341-4500  
Fax: 402-345-9318  
www.calenergy.com

## STOCK TRANSFER AGENT AND REGISTRAR

ChaseMellon Shareholder Services  
2323 Bryan Street, Suite 2300  
Dallas, Texas 75201-2656  
800-635-9270  
Overseas call collect at  
212-613-7427

## AUDITORS

Deloitte & Touche LLP  
2000 First National Center  
Omaha, NE 68102

## STOCK LISTINGS

New York Stock Exchange  
London Stock Exchange  
Pacific Stock Exchange  
Symbol: CE

## INVESTOR RELATIONS

Craig S. Allen  
Investor Relations Manager  
CalEnergy Company, Inc.  
302 S. 36th Street, Suite 400  
Omaha, NE 68131-3845  
Telephone: 402-231-1673  
Fax: 402-231-1578  
E-mail:  
craig.allen@calenergy.com

## FORM 10-K AND 8-K

*The Company's Annual Report on Form 10-K is filed with the Securities and Exchange Commission. Projects in operation, construction and development are subject to a number of uncertainties, more specifically described in the Company's Form 8-K, dated March 6, 1998, filed with the Securities and Exchange Commission. The Company will provide a copy of the Form 10-K and the Form 8-K without charge. Copies of exhibits to the Form 10-K will be furnished upon payment of a fee equal to the Company's reasonable expenses in furnishing such exhibits. Please direct your written requests to:*

## CRAIG S. ALLEN

Investor Relations Manager  
CalEnergy Company, Inc.  
302 S. 36th Street, Suite 400  
Omaha, NE 68131-3845

## CalEnergy Company, Inc. Senior Management:

**DAVID L. SOKOL**  
Chairman of the Board and  
Chief Executive Officer  
**GREGORY E. ABEL**  
President and Chief Operating Officer  
**STEVEN A. MCARTHUR**  
Executive Vice President,  
General Counsel and Secretary  
**CRAIG M. HAMMETT**  
Senior Vice President and  
Chief Financial Officer

**DOUGLAS L. ANDERSON**  
Assistant General Counsel  
and Assistant Secretary  
**DAVID A. BALDWIN**  
General Manager, Philippines  
**EDWARD F. BAZEMORE**  
Vice President, Human Resources

**ROBERT S. BECK**  
Director, Information Systems

**DONALD C. BLACHLY**  
General Manager, Coso  
Geothermal Operations

**MALCOLM G. CHANDLER**  
Director, Northern Electric and  
Managing Director, Supply

**P. ERIC CONNOR**  
Director, Northern Electric and  
Managing Director, Utility Services

**DAVE CROMPTON**  
Managing Director,  
Northern Electric Retail

**RICHARD B. DALTON**  
General Manager, Leyte  
Geothermal Operations

**ALAN DICKSON**  
Tax Manager, Northern Electric

**J. DOUGLAS DIVINE**  
Vice President, Project Development

**DAVID A. FAULKNER**  
Director, Personnel and Corporate  
Affairs, Northern Electric

**JOHN L. FEATHERSTONE**  
General Manager, Minerals

**VINCENT R. FESMIRE**  
Vice President, Construction  
and Engineering

**JAMES A. FLORES**  
Vice President, Project Finance

**ADRIAN M. FOLEY III**  
Vice President, Marketing

**DR. JOHN M. FRANCE**  
Regulation Director, Northern Electric

**G. VALERIE GILES**  
Company Secretary, Northern Electric

**PATRICK J. GOODMAN**  
Vice President, Chief Accounting  
Officer and Controller

**BRIAN K. HANKEL**  
Vice President and Treasurer

**EDWARD J. HEINRICH**  
General Manager, U.S. Gas Operations

## GARY L. HOOD

General Manager,  
NorCon Gas Operations

**WALTER G. KEENAN**  
Director, Human Resources

**DR. PHILIP S. LAWLESS**  
Managing Director, Generation,  
Northern Electric

**KENNETH R. LEWIS**  
General Manager,  
Power Resources Gas Operations

**KEN LINGE**  
Director, Financial Planning,  
Northern Electric

**STEVEN G. LYONS**  
Project Manager, Cascanan

**THOMAS R. MASON**  
President, CalEnergy  
Operating Company

**FREDERICK L. MANUEL**  
Vice President and Chief  
Operating Officer, Asia

**PATTI J. MCATEE**  
Director, Corporate Communications

**NEIL W. MIDGLEY**  
Managing Director,  
Northern Metering Services

**DONALD M. O'SHEI, JR.**  
President, CalEnergy  
Development Company

**DAVID PEARSON**  
Director, Marketing and Sales,  
Northern Electric

**STEVE RAINE**  
Managing Director,  
Northern Information Systems  
and Northern Electric Telecom

**P. DAN RORABAUGH**  
General Manager,  
Saranac Gas Operations

**JOHN A. SCHRETLEN**  
General Manager,  
Yuma Gas Operations

**JAMES J. SELLNER**  
Director, Taxation

**ROBERT S. SILBERMAN**  
Senior Vice President,  
Administration

**JAMES D. STALLMEYER**  
General Counsel, Northern Electric

**DAVID SWAN**  
Director, Northern Electric and  
Managing Director, Distribution

**JAMES T. TURNER**  
General Manager, Imperial  
Valley Geothermal Operations

**DAVID A. WATERS**  
Managing Director,  
Northern Utility Services

**JONATHAN M. WEISGALL**  
Vice President, Legislative and  
Regulatory Affairs

**PETER YOUNG**  
Managing Director,  
Gas Exploration and Development

## Board of Directors

**DAVID L. SOKOL**  
Chairman of the Board and  
Chief Executive Officer,  
CalEnergy Company, Inc.

**EDGAR D. ARONSON**  
President, EDACO, Inc.,  
New York, NY

**JUDITH E. AYRES**  
Principal, The Environmental Group,  
San Francisco, CA

**RICHARD K. DAVIDSON**  
Chairman, Union Pacific Corporation,  
Dallas, TX

**DAVID H. DEWHURST**  
Chairman and Chief Executive Officer,  
Falcon Seaboard Holdings, L.P.,  
Houston, TX

**RICHARD R. JAROS**  
President (retired), Kiewit Diversified  
Group, Inc., Omaha, NE

**DAVID R. MORRIS**  
Former Chairman,  
Northern Electric plc,  
Newcastle upon Tyne, U.K.

**BERNARD W. REZNICEK**  
National Director, Utility Marketing,  
Central States Indemnity Company  
of Omaha, Omaha, NE

**WALTER SCOTT, JR.**  
President and Chairman of the Board,  
Peter Kiewit Sons', Inc., Omaha, NE

**JOHN R. SHINER**  
Partner, Morrison & Foerster,  
Los Angeles, CA

**SIR NEVILLE TROTTER**  
Member of Parliament (retired),  
United Kingdom House of Commons

**DAVID E. WIT**  
Chief Executive Officer, Logica, Inc.,  
New York, NY

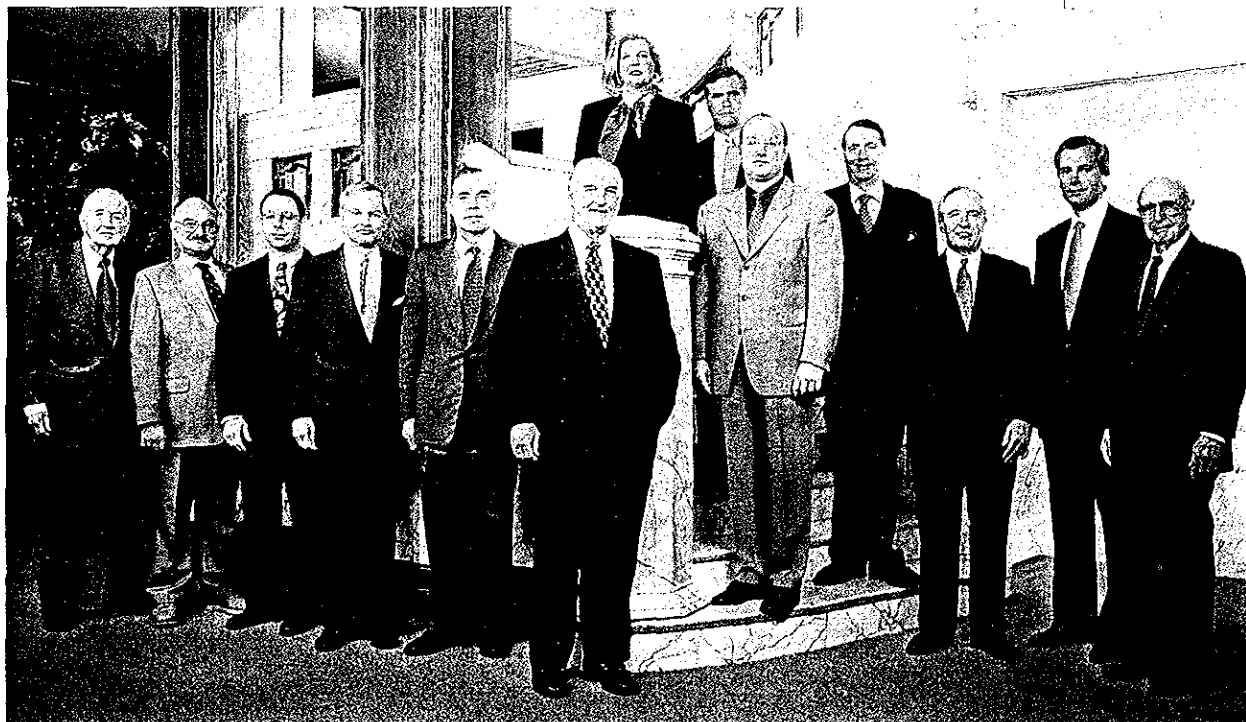
**BEN HOLT (EMERITUS)**  
Founder and Chairman (retired)  
CE Holt Company  
(formerly The Ben Holt Co.)  
Pasadena, CA

**EVERETT B. LAYBOURNE, ESQ.  
(EMERITUS)**  
Attorney at Law  
Los Angeles, CA

**BARTON W. SHACKELFORD  
(EMERITUS)**  
President (retired)  
Pacific Gas & Electric Company  
San Francisco, CA

## ANNUAL MEETING

The Annual Meeting of the Shareholders will be held on May 21, 1998 at 9:00 a.m. local time at Joslyn Art Museum, Witherspoon Concert Hall, 2200 Dodge Street, Omaha, Nebraska



## Board of Directors

### CalEnergy Company, Inc.

From left to right:

Everett B. Laybourne, Esq.  
Edgar D. Aronson  
David E. Wit  
John R. Shiner  
David R. Morris  
Walter Scott, Jr.  
Judith E. Ayres  
Richard R. Jaros  
David L. Sokol  
Sir Neville Trotter  
Bernard W. Reznicek  
David H. Dewhurst  
Ben Holt

*Emeritus Member, Attorney at Law, Los Angeles, CA*  
*President, EDACD, Inc., New York, NY*  
*Chief Executive Officer, Logicat, Inc., New York, NY*  
*Partner, Morrison & Foerster, Los Angeles, CA*  
*Former Chairman, Northern Electric plc, Newcastle upon Tyne, U.K.*  
*President and Chairman of the Board, Peter Kiewit Sons', Inc., Omaha, NE*  
*Principal, The Environmental Group, San Francisco, CA*  
*President (retired), Kiewit Diversified Group, Inc., Omaha, NE*  
*Chairman of the Board and Chief Executive Officer, CalEnergy Company, Inc.*  
*Member of Parliament (retired), United Kingdom House of Commons*  
*National Director, Utility Marketing, Central States Indemnity Company of Omaha, Omaha, NE*  
*Chairman and Chief Executive Officer, Falcon Seaboard Holdings, L.P., Houston, TX*  
*Emeritus Member, Founder and Chairman (retired), CE Holt Company (formerly The Ben Holt Co.), Pasadena, CA*

Not pictured:

Richard K. Davidson  
Barton W. Shackelford

*Chairman, Union Pacific Corporation, Dallas, TX*  
*Emeritus Member, President (retired), Pacific Gas & Electric Company, San Francisco, CA*

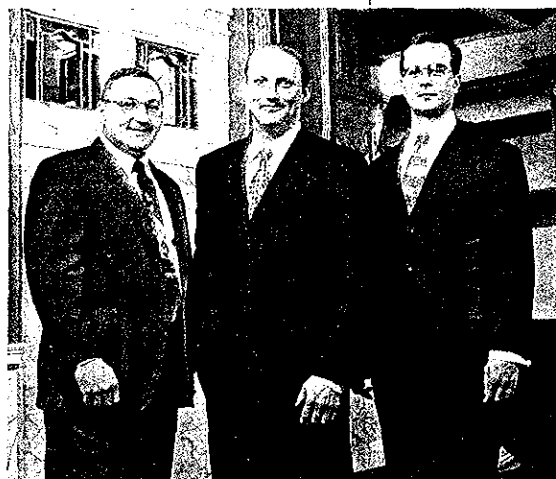
## Senior Management

### CalEnergy Company, Inc.

From left to right:

Steven A. McArthur  
Gregory E. Abel  
Craig M. Hammett

*Executive Vice President, General Counsel and Secretary*  
*President and Chief Operating Officer*  
*Senior Vice President and Chief Financial Officer*





**CalEnergy Company, Inc.**

**CalEnergy Company, Inc.  
302 South 36th Street, Suite 400  
Omaha, Nebraska 68131-3845**



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