

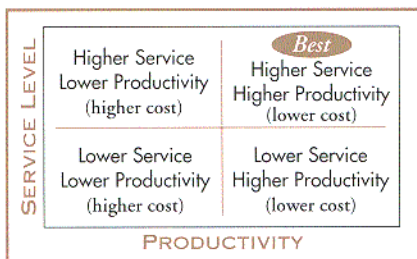
Ray Kreig, President

1996 was a very successful year for Chugach. In other parts of this annual report, you'll read about how we met our financial goals, increased revenues and margins without raising base residential rates, and improved customer service with innovations such as automatic bank payments and a new homepage on the World Wide Web. It was a busy year, too, as we set new targets for improvement of service and productivity.

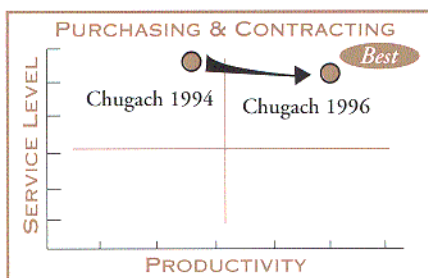
In mid-1995, the board and senior management agreed to an ambitious goal: to be among the top 10 percent of electric utilities in economic efficiency without sacrificing reliability or safety.

To meet this goal, we are participating in a series of benchmarking studies to compare many of our key functions against similar work done by other utilities.

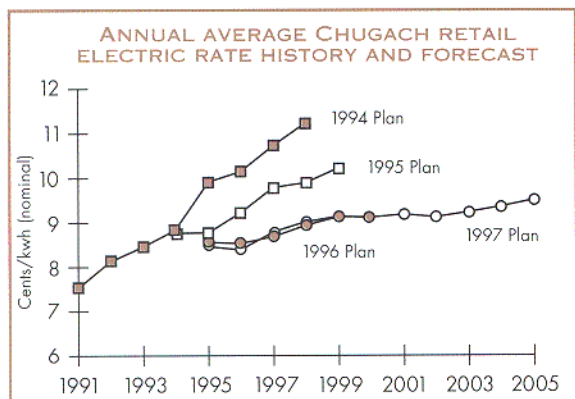
The results of these studies are typically graphed on a chart broken into four quadrants. The left axis measures "service level," while the bottom axis measures "productivity." For any benchmarked activity, a mark is placed on the chart for Chugach and other study participants. The goal is to be in the upper right corner of the chart, which indicates you are performing high quality work at a high rate of productivity or economic efficiency.



For example, in a 1995 study we evaluated our purchasing and contracting functions. The findings placed us in the top left quadrant, indicating that we were providing a relatively high level of service, but we weren't particularly cost effective in doing so. Staff subsequently modified the work flow and took full advantage of computerized systems allowing Chugach to cut staff and reduce costs. Based upon 1996 information, we moved into the top right hand quadrant, indicating we are continuing to provide high-quality service—and now at a more cost-efficient level. (See the special report on pages 14 and 15.) The results of these and other cost saving measures are dramatic! Under the 1994 plan, your retail cost for electricity would have been 10.8 cents per kilowatt hour in 1997—



almost 22 percent more than your cost in the new plan of 8.9 cents per kilowatt hour. As our efforts continue, I am confident that there will be even more savings in the future.



Ray Kreig

Ray Kreig
President

The goal of the board and management is for Chugach to “be among the top 10 percent of electric utilities in economic efficiency while maintaining national standards of reliability and safety.” That is in keeping with the goal of most customers who want reliable service at reasonable rates.

It's important to be able to compare and evaluate standards of service, reliability and price. That is where benchmarking comes in. In 1995 and 1996 Chugach participated in several benchmarking projects which compared CEA's key activities with other utilities.

A benchmarking study shows how our activities measure up to others in terms of service, satisfaction, productivity and costs. The goals are to identify potential savings and try and emulate the “best practices” of others.

This report highlights some of the savings and successes Chugach has achieved through benchmarking.

Success stories

Strategic alliances

Two strategic alliances for purchasing and warehousing are expected to yield savings of \$700,000 to \$800,000 in 1997.

The alliances will allow a major reduction in inventory levels, provide volume-pricing discounts and price stability—all of which contribute to lower operating costs.

As the alliances are implemented, Chugach will perform an inventory-use analysis. The goal is to achieve additional savings by eliminating unnecessary or seldom-used items.

Heavy crew size

In bringing the Operations Division in line with other utilities' best practices, Chugach cut labor costs by reducing a “heavy” maintenance crew from five to four linemen.

New service connect time

Chugach reduced the response time for a new service connection from six days to five days by simplifying the process and cutting the number of people involved. The goal is to create a single point of contact for customers.

Line extensions

When surveyed, customers said they felt it took too long for power to be extended to new locations. After a review of the best practices of other utilities, Chugach reduced the waiting time for a line extension by cutting the number of steps in the work process and eliminating duplicate efforts. That shortened both the overall process and the actual construction time.

Average construction time for line extensions under \$24,000



Field services

Chugach shifted some non-electrical field work from linemen and technicians to meter readers. These tasks include “read only” connects or disconnects, and distributing credit notices and other door tags. By redistributing the workload, Chugach lowered labor costs and increased productivity.

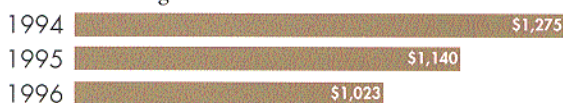
Annual field service expense



New service cost

From the benchmarking process, Chugach estimated the average cost of installing a new service was nearly \$1,300 in 1994. A review determined that more staff than necessary were being used. Streamlining the work flow helped cut 20 percent of the cost. By 1996, the cost had fallen to \$1,023 per service.

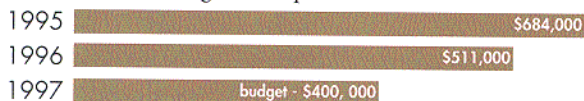
Cost of installing a new service



Meter reading

A comprehensive review revealed Chugach was about average in office-related customer service tasks, but below average in meter reading cost efficiency. Meter reading labor costs have since been lowered through a combination of automated meter reading and systematic estimated billings. By estimating bills as often as every other month, Chugach strives to keep customers at approximately 30-day billing cycles, and avoid annoying fluctuations caused by bad weather, holidays and illnesses.

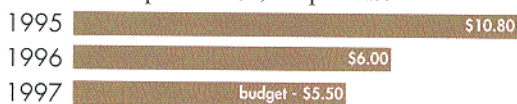
Annual meter reading labor expense



Purchasing

The cost of procuring items can be significant for an organization like Chugach, which buys nearly \$30 million of goods and services each year. Chugach has cut that cost dramatically in recent years. Automating and streamlining the process allowed Chugach to reduce staff and cut purchasing costs without sacrificing either customer satisfaction or competitiveness.

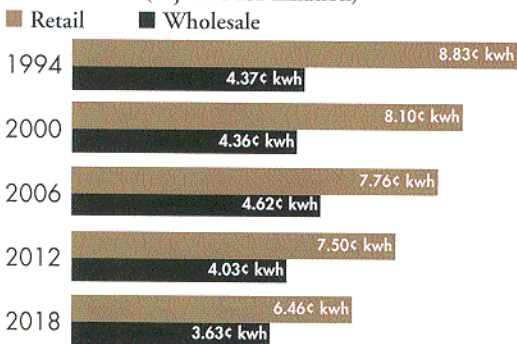
Labor costs to process a \$1,000 purchase



What lies ahead?

Through benchmarking Chugach is competing with the nation's best performers to give member-owners the best possible value. That, in turn, is helping Chugach move toward its goal of being "among the top 10 percent of electric utilities . . ." As sales grow and Chugach holds the growth in expenses below the rate of inflation, the "real" (adjusted for inflation) price of electricity is projected to decline. Savings from benchmarking will help Chugach hold down costs and keep rates low.

Revenue/Sales (adjusted for inflation)



Glossary

Benchmarking

A systematic process of collecting data relating to the services and work processes of other electric utilities, for the purposes of comparison and the identification of best practices.

Best practices

Technological innovations and work processes which improve economic efficiency while maintaining established system reliability, safety, value and service to our customers.

Heavy maintenance crews

A crew which performs maintenance work beyond the scope normally handled by an on-call service crew.

Line extension

Construction of electrical facilities from the end of an existing line to the location of a customer premise, that allows a service connection to be made.

Service connection

Installation of an electrical facility from an existing transformer, pole or other readily available power source to the customer's meter location.

Strategic alliance

A partnership relationship between a business and its suppliers which provides mutual benefits.

Unit price

A contractor price established for a particular electrical construction assembly for labor and material whereby the price can be used repeatedly for the same type of work on the project.

Work teams

Employees from different departments partnering on a single project or a process.