

CHUGACH ELECTRIC ASSOCIATION, INC.
ANCHORAGE, ALASKA

February 12, 2010

To: Mike Cunningham, Chief Financial Officer
From: Sherri McKay-Highers, Manager, Budget and Financial Reporting
Subject: 2009 Variance Report

Chugach closed 2009 with Operating Revenues of \$290.2 million, margins of \$5.7 million, a 1.27 Margins for Interest/Interest (MFI/I), a Times Interest Earned Ratio (TIER) of 1.28, current ratio of 0.68:1 and an equity to total capitalization ratio of 33.7%. The budget comparisons discussed below are based on the 2009 budget as approved.

kWh Sales

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Retail kWh Sales	1,183,704,950	1,201,311,337	1,205,831,517
Wholesale kWh Sales	<u>1,275,003,071</u>	<u>1,437,085,623</u>	<u>1,323,768,080</u>
Total Firm kWh Sales	2,458,708,021	2,638,396,960	2,529,599,597
Economy Energy kWh Sales	<u>76,968,300</u>	<u>73,000,000</u>	<u>256,105,420</u>
Total kWh Sales	2,535,676,321	2,711,396,960	2,785,705,017

Firm kWh sales totaled 2,458,708,021, which were 6.8% under the 2009 budget and 2.8% under 2008. Retail kWh sales were under budget by 1.5%. Significant factors contributing to the retail sales variance included lower than anticipated residential and commercial sales due primarily to warmer than anticipated weather, as well as observed patterns of conservation in response to increasing utility rates, and implementation of protective measures in response to the threat of ash fall from Mt. Redoubt that continued as additional conservation measures. Wholesale kWh sales were 11.3% under budget. A firm wholesale contract with Golden Valley Electric Association (GVEA) did not occur as anticipated and consequently represented approximately 80% of the overall wholesale sales variance. Additional factors contributing to the wholesale sales variance included lower than anticipated sales to Homer Electric Association (HEA) due to the impact of the shutdown of their industrial load in the second quarter to accommodate transmission line maintenance, power failures shutting down a large industrial consumer in the second quarter, impact from residential and commercial consumers implementing protective measures associated with the ash fall threat from Mt. Redoubt, warmer than anticipated weather and conservation in response to rising utility rates. That variance was somewhat offset by higher than anticipated sales to Matanuska Electric Association (MEA). Economy energy sales to GVEA totaled 76,968,300, in 2009, which were 5.4% over budget. That variance was due to more than anticipated sales under a new sales agreement negotiated with GVEA.

Retail kWh sales decreased 1.8%, while wholesale kWh sales decreased 3.7% in 2009 from 2008. The factors contributing to the retail sales variance included warmer weather, observed patterns of conservation and implementation of protective measures in response to the threat of ash fall from Mt. Redoubt that continued as additional conservation measures in 2009 compared to 2008. The significant factor contributing to the wholesale sales variance was decreased sales to HEA as a result of the impact of the shutdown of their industrial load to accommodate transmission line maintenance, power failures shutting down a large industrial consumer, the impact from residential and commercial consumers implementing protective measures associated with the ash fall threat from Mt. Redoubt, warmer weather and additional conservation in 2009 compared to 2008. Economy energy kWh sales decreased by 69.9% in 2009 from 2008. This variance was due to the lack of sales to GVEA for half of 2009, as a result of the expiration of our sales contract in March of 2009. The new sales agreement didn't get finalized until September of 2009.

Energy Revenue (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Retail Revenue	\$ 162.1	\$ 174.6	\$ 157.6
Wholesale Revenue	<u>118.2</u>	<u>142.7</u>	<u>109.4</u>
Total Firm Revenue	280.3	317.3	267.0
Economy Energy Revenue	<u>7.3</u>	<u>6.2</u>	<u>18.5</u>
Total Revenue	\$ 287.6	\$ 323.5	\$ 285.5

Revenue from firm sales totaled \$280.3 million in 2009 compared to \$317.3 million in the 2009 budget and \$267.0 million in 2008. Retail revenue was 7.1% under budget due primarily to lower than anticipated sales, as well as lower than anticipated fuel and purchased power expense included in revenue and recovered through the fuel and purchased power process due to lower than anticipated fuel costs and lower sales. Wholesale revenue was 17.1% under budget due to lower than anticipated sales to Homer Electric Association, lower than anticipated fuel and purchased power expense included in revenue and recovered through the fuel and purchased power process due to lower than anticipated fuel costs, lower sales and the fact that we did not finalized a firm contract with GVEA as anticipated. Economy energy revenue was 17.2% over budget caused by higher than anticipated sales to GVEA due to a new sales agreement.

Retail revenue increased in 2009 from 2008 due primarily to higher purchased power expense recovered through the fuel and purchased power process. This increase was partially offset by a decrease in base revenue due to a decrease in base rates charged to retail customers, as a result of Chugach's 2008 Test Year Rate Case and lower kWh sales caused by observed patterns of conservation and implementation of protective measures in response to the threat of volcanic ash fall that continued as additional conservation measures. Wholesale revenue increased in 2009 from 2008 caused by higher base rates charged to wholesale customers as a result of the aforementioned rate case and higher purchased power costs recovered in revenue through the fuel surcharge process. This increase was partially offset by lower kWh sales caused by conservation and protection measures in response to the threat of volcanic ash fall that continued as additional

conservation measures. Economy energy revenue decreased in 2009 from 2008 due to the lack of sales to GVEA for half of 2009 as discussed above.

Other Operating Revenue (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Other Operating Revenue	\$ 2.6	\$ 3.0	\$ 2.8

Other operating revenue includes late fees, pole rental, wheeling, microwave and miscellaneous service and other electric revenue. Other operating revenue for 2009 totaled \$2.6 million compared to \$3.0 million in the 2009 budget and \$2.8 million in 2008. The variance from budget was due to less than expected wheeling and other electric revenue.

Other operating revenue decreased in 2009 from 2008 due primarily to a decrease in other electric revenue.

Power Production (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Operating & Maintenance	\$ 16.4	\$ 17.9	\$ 16.7
Fuel	<u>136.4</u>	<u>164.9</u>	<u>137.9</u>
Total	\$ 152.8	\$ 182.8	\$ 154.6

Power production operating and maintenance expense for 2009 was \$16.4 million compared to \$17.9 million in the 2009 budget and \$16.7 million in 2008. Higher than anticipated costs associated with the full charges of the Beluga Unit #8 major inspection completed in 2008, additional expenses associated with the Beluga Unit #8 repairs in 2009, water injection costs at the Bernice Lake power plant and higher than anticipated costs allocated from Information Services and the warehouse were more than offset by the postponement of the Bernice Unit #3 major inspection, Beluga Unit #3 and Unit #5 combustion inspections and the Beluga Unit #1 hot gas path inspection. Significant restrictions on travel and training, lower labor expense due to vacancies, more than anticipated capitalized labor and lower than anticipated expenses associated with consulting, operations and maintenance assessments also contributed to the favorable budget variance. The costs associated with the repairs of Cooper Lake Unit #2 in the first quarter of 2009 were reclassified from expense to deferred.

Power production operating and maintenance expense did not materially change in 2009 from 2008. Though not a significant overall variance, labor increased due primarily to a shift from capital to expense. That increase was more than offset by a decrease in transportation costs and Eklutna maintenance expense. Furthermore, amortization decreased in 2009 from 2008 due to a decrease in the amortization associated with the Beluga River Gas Compression project and the Beluga Unit 8 overhaul costs caused by the accelerated amortization of the prior overhaul in 2008 due to a change to the maintenance schedule.

Fuel expense in 2009 was \$136.4 million compared to \$164.9 million in the 2009 budget and \$137.9 million in 2008. The variance from budget was caused by less than anticipated MCF purchased due primarily to lower than anticipated sales, lower average fuel prices and the fact that we did not finalized a firm contract with GVEA as anticipated. Actual fuel purchased in 2009 was 26,139,407 MCF at an average effective price of \$6.08 per MCF, which did not include 3,711,074 MCF of fuel that was recorded as purchased power compared to 29,083,215 MCF in the 2009 budget at an average effective price of \$6.59 per MCF, which did not include 4,051,250 MCF of fuel that was recorded as purchased power.

The decrease in fuel expense in 2009 from 2008 was primarily a result of a decrease in MCF used, as a result of lower kWh and economy sales, despite a higher average effective fuel price. In 2009, Chugach used 26,139,407 MCF of fuel at an average effective price of \$6.08 per MCF, which did not include 3,711,074 MCF of fuel that was recorded as purchased power compared to 30,792,658 MCF of fuel used in 2008 at an average effective price of \$5.13 per MCF, which did not include 3,895,468 MCF of fuel that was recorded as purchased power.

Purchased Power (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Total Purchased Power	\$ 35.7	\$ 39.0	\$ 31.5

Purchased power cost for 2009 totaled \$35.7 million compared to \$39.0 million in the 2009 budget and \$31.5 million in 2008. The budget variance was caused by more than anticipated energy purchased which was offset by a lower average effective price caused primarily by lower than anticipated fuel costs. In 2009, we purchased 502,063 MWh of energy at an average effective price of 6.81 cents per kWh compared to 486,467 MWh of energy at an average effective price of 7.74 cents per kWh in the 2009 budget.

The increase in purchased power expense in 2009 from 2008 was due primarily to an increase in MWh purchased and a higher average effective price caused by higher fuel prices. In 2009, Chugach purchased 502,063 MWh of energy at an average effective price of 6.81 cents per kWh compared to 483,742 MWh of energy at an average effective price of 6.24 cents per kWh in 2008.

Transmission Operations and Maintenance (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Total Transmission	\$ 5.7	\$ 6.3	\$ 5.8

Transmission operations and maintenance expense totaled \$5.7 million in 2009 compared to \$6.3 million in the 2009 budget and \$5.8 million in 2008. This budget variance was due primarily to lower labor as a result of vacancies and a higher concentration of distribution and deferred reimbursable work being performed. Professional services also contributed to this variance due primarily to lower costs associated with the deferral of

substation maintenance. That variance was somewhat offset by higher than anticipated lease expense.

Transmission Operations and Maintenance expense did not materially change in 2009 from 2008. While not a significant overall variance, an increase in labor was offset by a decrease in professional services associated with substation maintenance.

Distribution Operations and Maintenance (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Total Distribution	\$ 12.7	\$ 12.5	\$ 12.4

Distribution operations and maintenance expenses totaled \$12.7 million in 2009 compared to \$12.5 million in the 2009 budget and \$12.4 million in 2008. While not a significant overall budget variance, labor was over due to weather related repairs and a higher concentration of distribution rather than transmission work being performed. These expenses were offset by lower materials due to the postponement of several substation maintenance projects and lower than anticipated professional services associated with right of way clearing.

The increase in distribution operations and maintenance expense in 2009 from 2008 was due primarily to an increase in labor and professional services related to right-of-way clearing.

Consumer Accounts (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Total Consumer Accounts	\$ 4.6	\$ 4.7	\$ 4.8

Consumer accounts expense totaled \$4.6 million in 2009 compared to \$4.7 million in the 2009 budget and \$4.8 million in 2008. While not a significant overall variance, higher than anticipated uncollectible accounts was somewhat offset by lower than anticipated costs allocated from Information Services.

Consumer accounts expense decreased in 2009 from 2008 due primarily to a decrease in credit card processing.

Customer Information (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Total Customer Information	\$ 0.7	\$ 0.9	\$ 0.6

Customer information expense totaled \$0.7 million in 2009 compared to \$0.9 million in the 2009 budget and \$0.6 million in 2008. The budget variance was due primarily to expenses associated with a corporate communications plan which was recorded as an administrative and general expense as well as less than anticipated expenses associated with the Smart Power Incentive program.

Customer information increased in 2009 from 2008 due primarily to materials purchased for the Smart Power program.

Administrative and General (in millions)

	<u>2009 Actual</u>	<u>2009 Budget</u>	<u>2008 Actual</u>
Total Administrative and General	\$ 18.2	\$ 20.4	\$ 19.1

Administrative and general expense totaled \$18.2 million in 2009 compared to \$20.4 million in the 2009 budget and \$19.1 million in 2008. This category was under budget in allocated costs from Information Services, financial advisory and audit expenses, building maintenance and utilities, planning and strategic activities, human resource programs, regulatory and legal costs, rating agency fees, travel, training and Board of Directors expenses. Those items under budget were slightly offset by process improvement expenses and a corporate communications plan, which was budgeted to the customer information financial statement category.

Administrative and general expense decreased in 2009 from 2008. The decrease was due primarily to professional services associated with Sarbanes-Oxley Compliance and audit services, legal services and Board of Directors expenses. The decrease was partially offset by an increase in labor.

The summary of all the 2009 operations and maintenance expenses total \$230.5 million compared to \$266.6 million in the 2009 budget and \$228.8 million in 2008.

Depreciation expense totaled \$32.1 million in 2009 compared to \$32.4 million in the 2009 budget and \$30.8 million in 2008. There was no significant variance in depreciation expense from the 2009 budget. The increase in depreciation expense in 2009 from 2008 was due primarily to the closeout of construction projects.

Tax expense for 2009 totaled \$0.8 million compared to \$0.8 million in the 2009 budget and \$0.8 million in 2008. There were no significant changes or variances from the 2009 budget or 2008 actual expenses.

Long-term interest expense totaled \$20.2 million in 2009 compared to \$21.0 million in the 2009 budget and \$21.3 million in 2008. The budget variance was due primarily to lower than anticipated interest rates. The decrease in 2009 from 2008 was largely due to the use of our NRUCFC line of credit to redeem the outstanding principal amount of the 2002 Series B Bonds in March of 2008, resulting in a shift from long-term to short-term interest expense. The decrease was also due to lower interest rates and continued principal payments on our CoBank debt in 2009.

Interest during construction totaled \$0.6 million in 2009 compared to \$1.4 million in the 2009 budget and \$0.4 million in 2008. The variance from the 2009 budget was due primarily to a lower than anticipated average Construction Work In Progress (CWIP) balance caused by less construction activity than anticipated and lower than anticipated interest rates. The increase from 2008 was largely due to a higher average balance in CWIP, caused primarily by capital spending associated with the Southcentral Power

Project (SPP), which was slightly offset by a lower weighted average rate in 2009 from 2008.

Other interest expense totaled \$1.0 million compared to \$1.9 million in the 2009 budget and \$1.7 million in 2008. The variance from the 2009 budget was due primarily to a lower than anticipated line of credit balance caused by less than anticipated capital spending and lower than anticipated interest rates on our commercial paper. We had no outstanding balance on our NRUCFC line of credit and \$51.5 million of commercial paper outstanding at December 31, 2009. The decrease in 2009 from 2008 was largely due to the difference between the balance of the NRUCFC line of credit used in 2008 to redeem the 2002 Series B Bonds and the balance of commercial paper outstanding which was used to pay the balance of the NRUCFC line of credit in 2009. The decrease was also due to the difference in interest rates between the NRUCFC line of credit in 2008 and the commercial paper interest rates in 2009. These decreases were slightly offset by a shift from long-term to short-term interest expense described above.

Other deductions include donations, preliminary survey and investigation charges of abandoned projects and obsolete inventory write-offs. In 2009, other deductions totaled \$1.5 million compared to \$0.3 million in the 2009 budget and \$0.1 million in 2008. The variance from the 2009 budget and from 2008 was due to the write off of obsolete inventory and cancelled projects, primarily the obsolete design for the rebuild of International Substation due to a change in the protection and control equipment and stricter seismic requirements.

All of the foregoing expenses resulted in total cost of electric service in 2009 of \$285.5 million compared to \$321.6 million in the 2009 budget and \$283.1 million in 2008.

Non-operating margins include interest income, Allowance for Funds Used During Construction (AFUDC), capital credit and patronage capital allocations and extraordinary items. In 2009, non-operating margins totaled \$0.9 million compared to \$0.9 million in the 2009 budget and \$1.2 million in 2008. There was no significant variance from the 2009 budget. The decrease in 2009 from 2008 was due primarily to lower interest income as a result of a lower cash balance and lower interest rates and lower patronage capital due to a decrease in our total debt outstanding with CoBank.

The net result of revenue and expenses in 2009 was margins of \$5.7 million compared to projected margins of \$5.8 million in the 2009 budget and margins of \$6.4 million in 2008. These results gave Chugach an MFI/I of 1.27, a TIER of 1.28 and an equity-to-total-capitalization ratio of 33.7%. The year-end current ratio was 0.68:1.