

HAWAIIAN ELECTRIC INDUSTRIES INC  
Form 10-Q  
August 06, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D. C. 20549**  
**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2007

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Exact Name of Registrant as Specified in Its Charter	Commission File Number	I.R.S. Employer Identification No.
HAWAIIAN ELECTRIC INDUSTRIES, INC. and Principal Subsidiary	1-8503	99-0208097
HAWAIIAN ELECTRIC COMPANY, INC.	1-4955	99-0040500

**State of Hawaii**

*(State or other jurisdiction of incorporation or organization)*

900 Richards Street, Honolulu, Hawaii 96813

*(Address of principal executive offices and zip code)*

Hawaiian Electric Industries, Inc. --- (808) 543-5662

Hawaiian Electric Company, Inc. ----- (808) 543-7771

*(Registrant's telephone number, including area code)*

Not applicable

*(Former name, former address and former fiscal year, if changed since last report)*

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Indicate by check mark whether Registrant Hawaiian Electric Industries, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether Registrant Hawaiian Electric Company, Inc. (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether Registrant Hawaiian Electric Industries, Inc. is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether Registrant Hawaiian Electric Company, Inc. is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether Registrant Hawaiian Electric Industries, Inc. is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate by check mark whether Registrant Hawaiian Electric Company, Inc. is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

### APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuers' classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding July 30, 2007
Hawaiian Electric Industries, Inc. (Without Par Value)	82,523,125 Shares
Hawaiian Electric Company, Inc. (\$6-2/3 Par Value)	12,805,843 Shares (not publicly traded)

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**Hawaiian Electric Industries, Inc. and Subsidiaries**

**Hawaiian Electric Company, Inc. and Subsidiaries**

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Hawaiian Electric Industries, Inc. and Subsidiaries

Hawaiian Electric Company, Inc. and Subsidiaries

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**GLOSSARY OF TERMS**

<b>Terms</b>	<b><u>Definitions</u></b>
<b>AFUDC</b>	Allowance for funds used during construction
<b>AOCI</b>	Accumulated other comprehensive income
<b>ASB</b>	American Savings Bank, F.S.B., a wholly-owned subsidiary of HEI Diversified, Inc. and parent company of American Savings Investment Services Corp. (and its subsidiary, Bishop Insurance Agency of Hawaii, Inc.). AdCommunications, Inc. (dissolved in May 2007) is a former subsidiary.
<b>CHP</b>	Combined heat and power
<b>Company</b>	Hawaiian Electric Industries, Inc. and its direct and indirect subsidiaries, including, without limitation, Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., Maui Electric Company, Limited, HECO Capital Trust III (unconsolidated subsidiary), Renewable Hawaii, Inc., HEI Diversified, Inc., American Savings Bank, F.S.B. and its subsidiaries, Pacific Energy Conservation Services, Inc., HEI Properties, Inc., HEI Investments, Inc., Hycap Management, Inc. (in dissolution), Hawaiian Electric Industries Capital Trust II (unconsolidated subsidiary), Hawaiian Electric Industries Capital Trust III (unconsolidated subsidiary) and The Old Oahu Tug Service, Inc. Former subsidiaries include HEIPC (discontinued operations, dissolved in 2006) and its dissolved subsidiaries.
<b>Consumer Advocate</b>	Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii
<b>D&amp;O</b>	Decision and order
<b>DG</b>	Distributed generation
<b>DOD</b>	Department of Defense -- federal
<b>DOH</b>	Department of Health of the State of Hawaii
<b>DRIP</b>	HEI Dividend Reinvestment and Stock Purchase Plan
<b>DSM</b>	Demand-side management
<b>EPA</b>	Environmental Protection Agency -- federal
<b>Exchange Act</b>	Securities Exchange Act of 1934
<b>FASB</b>	Financial Accounting Standards Board
<b>Federal</b>	U.S. Government
<b>FHLB</b>	Federal Home Loan Bank
<b>FIN</b>	Financial Accounting Standards Board Interpretation No.
<b>GAAP</b>	U.S. generally accepted accounting principles
<b>HECO</b>	Hawaiian Electric Company, Inc., an electric utility subsidiary of Hawaiian Electric Industries, Inc. and parent company of Maui Electric Company, Limited, Hawaii Electric Light Company, Inc., HECO Capital Trust III (unconsolidated subsidiary) and Renewable Hawaii, Inc.

**Table of Contents****GLOSSARY OF TERMS, continued**

<b>Terms</b>	<b>Definitions</b>
<b>HEI</b>	Hawaiian Electric Industries, Inc., direct parent company of Hawaiian Electric Company, Inc., HEI Diversified, Inc., Pacific Energy Conservation Services, Inc., HEI Properties, Inc., HEI Investments, Inc., Hycap Management, Inc. (in dissolution), Hawaiian Electric Industries Capital Trust II (unconsolidated subsidiary), Hawaiian Electric Industries Capital Trust III (unconsolidated subsidiary) and The Old Oahu Tug Service, Inc. Former subsidiaries include HEI Power Corp. (discontinued operations, dissolved in 2006).
<b>HEIDI</b>	HEI Diversified, Inc., a wholly owned subsidiary of Hawaiian Electric Industries, Inc. and the parent company of American Savings Bank, F.S.B.
<b>HEIII</b>	HEI Investments, Inc. (formerly HEI Investment Corp.), a subsidiary of HEI Power Corp.
<b>HEIPC</b>	HEI Power Corp., a formerly wholly owned subsidiary of Hawaiian Electric Industries, Inc., and the former parent company of numerous subsidiaries, the majority of which were dissolved or otherwise wound up since 2002, pursuant to a formal plan to exit the international power business (formerly engaged in by HEIPC and its subsidiaries) adopted by the HEI Board of Directors in October 2001. HEIPC was dissolved in December 2006.
<b>HEIRSP</b>	Hawaiian Electric Industries Retirement Savings Plan
<b>HELCO</b>	Hawaii Electric Light Company, Inc., an electric utility subsidiary of Hawaiian Electric Company, Inc.
<b>HPOWER</b>	City and County of Honolulu with respect to a power purchase agreement for a refuse-fired plant
<b>IPP</b>	Independent power producer
<b>IRP</b>	Integrated resource plan
<b>KWH</b>	Kilowatthour
<b>MECO</b>	Maui Electric Company, Limited, an electric utility subsidiary of Hawaiian Electric Company, Inc.
<b>MW</b>	Megawatt/s (as applicable)
<b>NII</b>	Net interest income
<b>NPV</b>	Net portfolio value
<b>O&amp;M</b>	Operation and maintenance
<b>PPA</b>	Power purchase agreement
<b>PRPs</b>	Potentially responsible parties
<b>PUC</b>	Public Utilities Commission of the State of Hawaii
<b>RHI</b>	Renewable Hawaii, Inc., a wholly owned subsidiary of Hawaiian Electric Company, Inc.
<b>ROACE</b>	Return on average common equity
<b>ROR</b>	Return on average rate base
<b>SEC</b>	Securities and Exchange Commission
<b>See</b>	Means the referenced material is incorporated by reference
<b>SFAS</b>	Statement of Financial Accounting Standards
<b>SOIP</b>	1987 Stock Option and Incentive Plan, as amended
<b>SOX</b>	Sarbanes-Oxley Act of 2002
<b>SPRBs</b>	Special Purpose Revenue Bonds
<b>TOOTS</b>	The Old Oahu Tug Service, a wholly owned subsidiary of Hawaiian Electric Industries, Inc.
<b>VIE</b>	Variable interest entity

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**FORWARD-LOOKING STATEMENTS**

This report and other presentations made by Hawaiian Electric Industries, Inc. (HEI) and Hawaiian Electric Company, Inc. (HECO) and their subsidiaries contain forward-looking statements, which include statements that are predictive in nature, depend upon or refer to future events or conditions, and usually include words such as expects, anticipates, intends, plans, believes, predicts, estimates or similar expressions. In addition, any statements concerning future financial performance, ongoing business strategies or prospects and possible future actions are also forward-looking statements. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties and the accuracy of assumptions concerning HEI and its subsidiaries (collectively, the Company), the performance of the industries in which they do business and economic and market factors, among other things. **These forward-looking statements are not guarantees of future performance.**

Risks, uncertainties and other important factors that could cause actual results to differ materially from those in forward-looking statements and from historical results include, but are not limited to, the following:

the effects of international, national and local economic conditions, including the state of the Hawaii tourist and construction industries, the strength or weakness of the Hawaii and continental U.S. real estate markets (including the fair value of collateral underlying loans and mortgage-related securities) and decisions concerning the extent of the presence of the federal government and military in Hawaii;

the effects of weather and natural disasters, such as hurricanes, earthquakes, tsunamis and the potential effects of global warming;

global developments, including the effects of terrorist acts, the war on terrorism, continuing U.S. presence in Iraq and Afghanistan, potential conflict or crisis with North Korea and in the Middle East, Iran's nuclear activities and potential avian flu pandemic;

the timing and extent of changes in interest rates and the shape of the yield curve;

the risks inherent in changes in the value of and market for securities available for sale and pension and other retirement plan assets;

changes in assumptions used to calculate retirement benefits costs and changes in funding requirements;

increasing competition in the electric utility and banking industries (e.g., increased self-generation of electricity may have an adverse impact on HECO's revenues and increased price competition for deposits, or an outflow of deposits to alternative investments, may have an adverse impact on American Savings Bank, F.S.B.'s (ASB's) cost of funds);

capacity and supply constraints or difficulties, especially if generating units (utility-owned or independent power producer (IPP)-owned) fail or measures such as demand-side management (DSM), distributed generation (DG), combined heat and power (CHP) or other firm capacity supply-side resources fall short of achieving their forecasted benefits or are otherwise insufficient to reduce or meet peak demand;

increased risk to generation reliability as generation peak reserve margins on Oahu continue to be strained;

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fuel oil price changes, performance by suppliers of their fuel oil delivery obligations and the continued availability to the electric utilities of their energy cost adjustment clauses (ECACs);

the ability of IPPs to deliver the firm capacity anticipated in their power purchase agreements (PPAs);

the ability of the electric utilities to negotiate, periodically, favorable fuel supply and collective bargaining agreements;

new technological developments that could affect the operations and prospects of HEI and its subsidiaries (including HECO and its subsidiaries and ASB and its subsidiaries) or their competitors;

federal, state and international governmental and regulatory actions, such as changes in laws, rules and regulations applicable to HEI, HECO, ASB and their subsidiaries (including changes in taxation, environmental laws and regulations, the potential regulation of greenhouse gas emissions and governmental fees and assessments); decisions by the Public Utilities Commission of the State of Hawaii (PUC) in rate cases (including decisions on ECACs) and other proceedings and by other agencies and courts on land use, environmental and other permitting issues; required corrective actions, restrictions and penalties (that may arise, for example, with respect to environmental conditions, renewable portfolio standards (RPS), capital adequacy and business practices);

increasing operation and maintenance expenses for the electric utilities, resulting in the need for more frequent rate cases, and increasing noninterest expenses at ASB;

the risks associated with the geographic concentration of HEI's businesses;

the effects of changes in accounting principles applicable to HEI, HECO, ASB and their subsidiaries, including the adoption of new accounting principles (such as the effects of Statement of Financial Accounting Standards (SFAS) No. 158 regarding employers accounting for defined benefit pension and other postretirement plans), continued regulatory accounting under SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, and the possible effects of applying Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 46R, Consolidation of Variable Interest Entities, and Emerging Issues Task Force Issue No. 01-8, Determining Whether an Arrangement Contains a Lease, to PPAs with independent power producers;

the effects of changes by securities rating agencies in their ratings of the securities of HEI and HECO and the results of financing efforts;

faster than expected loan prepayments that can cause an acceleration of the amortization of premiums on loans and investments and the impairment of mortgage servicing rights of ASB;

changes in ASB's loan portfolio credit profile and asset quality which may increase or decrease the required level of allowance for loan losses;

changes in ASB's deposit cost or mix which may have an adverse impact on ASB's cost of funds;

the final outcome of tax positions taken by HEI, HECO, ASB and their subsidiaries;

the ability of consolidated HEI to generate capital gains and utilize capital loss carryforwards on future tax returns;

the risks of suffering losses and incurring liabilities that are uninsured; and

other risks or uncertainties described elsewhere in this report and in other periodic reports (e.g., Item 1A. Risk Factors in the Company's Annual Report on Form 10-K) previously and subsequently filed by HEI and/or HECO with the Securities and Exchange Commission (SEC).

Forward-looking statements speak only as of the date of the report, presentation or filing in which they are made. Except to the extent required by the federal securities laws, HEI, HECO, ASB and their subsidiaries undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.



**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Statements of Income (unaudited)**

	Three months ended		Six months ended	
	June 30		June 30	
	2007	2006	2007	2006
<b>(in thousands, except per share amounts and ratio of earnings to fixed charges)</b>				
<b>Revenues</b>				
Electric utility	\$ 492,712	\$ 503,967	\$ 940,390	\$ 979,023
Bank	107,526	102,556	211,986	202,560
Other	525	(1,554)	2,410	(1,652)
	<b>600,763</b>	<b>604,969</b>	<b>1,154,786</b>	<b>1,179,931</b>
<b>Expenses</b>				
Electric utility	463,923	464,121	898,609	893,597
Bank	87,832	76,397	173,864	149,386
Other	3,699	3,722	8,463	7,068
	<b>555,454</b>	<b>544,240</b>	<b>1,080,936</b>	<b>1,050,051</b>
<b>Operating income (loss)</b>				
Electric utility	28,789	39,846	41,781	85,426
Bank	19,694	26,159	38,122	53,174
Other	(3,174)	(5,276)	(6,053)	(8,720)
	<b>45,309</b>	<b>60,729</b>	<b>73,850</b>	<b>129,880</b>
Interest expense other than on deposit liabilities				
and other bank borrowings	(19,282)	(19,134)	(39,793)	(38,251)
Allowance for borrowed funds used during construction	586	719	1,184	1,421
Preferred stock dividends of subsidiaries	(473)	(473)	(946)	(946)
Allowance for equity funds used during construction	1,202	1,588	2,434	3,136
	<b>27,342</b>	<b>43,429</b>	<b>36,729</b>	<b>95,240</b>
Income taxes	9,793	16,205	12,416	35,679
	<b>\$ 17,549</b>	<b>\$ 27,224</b>	<b>\$ 24,313</b>	<b>\$ 59,561</b>
<b>Net income</b>				
Basic earnings per common share	\$ 0.21	\$ 0.34	\$ 0.30	\$ 0.73
Diluted earnings per common share	\$ 0.21	\$ 0.33	\$ 0.30	\$ 0.73
Dividends per common share	\$ 0.31	\$ 0.31	\$ 0.62	\$ 0.62

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Weighted-average number of common shares outstanding	81,907	81,100	81,679	81,041
Dilutive effect of stock options and dividend equivalents	217	332	227	319
Adjusted weighted-average shares	82,124	81,432	81,906	81,360
Ratio of earnings to fixed charges (SEC method)				
Excluding interest on ASB deposits			1.44	2.21
Including interest on ASB deposits			1.29	1.85

See accompanying Notes to Consolidated Financial Statements for HEI.

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Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Balance Sheets (unaudited)**

	June 30,	December 31,
(dollars in thousands)	2007	2006
<b>Assets</b>		
Cash and equivalents	\$ 152,163	\$ 177,630
Federal funds sold	75,144	79,671
Accounts receivable and unbilled revenues, net	250,990	248,639
Available-for-sale investment and mortgage-related securities	2,301,360	2,367,427
Investment in stock of Federal Home Loan Bank of Seattle, at cost	97,764	97,764
Loans receivable, net	3,887,739	3,780,461
Property, plant and equipment, net of accumulated depreciation of \$1,705,833 and \$1,651,088	2,656,139	2,647,490
Regulatory assets	132,605	112,349
Other	316,522	292,638
Goodwill and other intangibles, net	87,130	87,140
	\$ 9,957,556	\$ 9,891,209
<b>Liabilities and stockholders equity</b>		
<b>Liabilities</b>		
Accounts payable	\$ 171,941	\$ 165,505
Deposit liabilities	4,432,341	4,575,548
Short-term borrowings other than bank	125,465	176,272
Other bank borrowings	1,718,027	1,568,585
Long-term debt, net other than bank	1,230,824	1,133,185
Deferred income taxes	83,430	106,780
Regulatory liabilities	251,198	240,619
Contributions in aid of construction	281,944	276,728
Other	519,695	518,454
	8,814,865	8,761,676
<b>Minority interests</b>		
Preferred stock of subsidiaries - not subject to mandatory redemption	34,293	34,293
<b>Stockholders equity</b>		
Preferred stock, no par value, authorized 10,000,000 shares; issued: none		
Common stock, no par value, authorized 200,000,000 shares; issued and outstanding: 82,391,429 shares and 81,461,409 shares	1,048,562	1,028,101
Retained earnings	216,063	242,667
Accumulated other comprehensive loss, net of tax benefits	(156,227)	(175,528)
	1,108,398	1,095,240
	\$ 9,957,556	\$ 9,891,209

See accompanying Notes to Consolidated Financial Statements for HEI.



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Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Statements of Changes in Stockholders' Equity (unaudited)**

	Common stock		Retained earnings	Accumulated other comprehensive loss		Total
	Shares	Amount		loss		
(in thousands, except per share amounts)						
<b>Balance, December 31, 2006</b>	<b>81,461</b>	<b>\$ 1,028,101</b>	<b>\$ 242,667</b>	<b>\$ (175,528)</b>	<b>\$ 1,095,240</b>	
Comprehensive income:						
Net income			24,313			24,313
Net unrealized losses on securities arising during						
the period, net of tax benefits of \$1,989				(3,012)		(3,012)
Defined benefit retirement plans' amortization						
of net loss, prior service cost and transition						
obligation included in net periodic benefit cost,						
net of taxes of \$2,622				4,108		4,108
Comprehensive income			24,313	1,096		25,409
Adjustment to initially apply a PUC D&O						
related to defined benefit retirement plans,						
net of taxes of \$11,595				18,205		18,205
Adjustment to initially apply FIN 48			(228)			(228)
Issuance of common stock, net	930	20,461				20,461
Common stock dividends (\$0.62 per share)			(50,689)			(50,689)
<b>Balance, June 30, 2007</b>	<b>82,391</b>	<b>\$ 1,048,562</b>	<b>\$ 216,063</b>	<b>\$ (156,227)</b>	<b>\$ 1,108,398</b>	
<b>Balance, December 31, 2005</b>	<b>80,983</b>	<b>\$ 1,018,966</b>	<b>\$ 235,394</b>	<b>\$ (37,730)</b>	<b>\$ 1,216,630</b>	
Comprehensive income:						
Net income			59,561			59,561
Net unrealized losses on securities arising during						
the period, net of tax benefits of \$16,697				(25,290)		(25,290)
Minimum pension liability adjustment,						
net of tax benefits of \$30				(48)		(48)
Comprehensive income (loss)			59,561	(25,338)		34,223
Issuance of common stock, net	292	4,598				4,598
Common stock dividends (\$0.62 per share)			(50,310)			(50,310)

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<b>Balance, June 30, 2006</b>	<b>81,275</b>	<b>\$ 1,023,564</b>	<b>\$ 244,645</b>	<b>\$</b>	<b>(63,068)</b>	<b>\$ 1,205,141</b>
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See accompanying Notes to Consolidated Financial Statements for HEI.

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Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Statements of Cash Flows (unaudited)**

Six months ended June 30 (in thousands)	2007	2006
<b>Cash flows from operating activities</b>		
Net income	\$ 24,313	\$ 59,561
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation of property, plant and equipment	74,057	70,574
Other amortization	4,576	4,211
Writedown of utility plant	11,701	
Provision for loan losses	1,200	
Deferred income taxes	(12,120)	(7,498)
Allowance for equity funds used during construction	(2,434)	(3,136)
Excess tax benefits from share-based payment arrangements	(259)	(567)
Loans receivable originated and purchased, held for sale	(19,174)	(11,257)
Proceeds from sale of loans receivable, held for sale	27,439	23,750
Changes in assets and liabilities, net of effects from the disposal of businesses		
Decrease (increase) in accounts receivable and unbilled revenues, net	(2,351)	1,656
Increase in fuel oil stock	(24,148)	(28,024)
Decrease in federal tax deposit		30,000
Increase in accounts payable	6,436	4,905
Decrease in taxes accrued	(7,136)	(489)
Changes in other assets and liabilities	(2,685)	4,003
<b>Net cash provided by operating activities</b>	<b>79,415</b>	<b>147,689</b>
<b>Cash flows from investing activities</b>		
Available-for-sale investment and mortgage-related securities purchased	(199,315)	(175,000)
Principal repayments on available-for-sale investment and mortgage-related securities	258,625	254,109
Net increase in loans held for investment	(114,094)	(159,096)
Net proceeds from sale of investments	8,775	
Capital expenditures	(79,886)	(97,691)
Contributions in aid of construction	7,576	10,622
Other	458	1,436
<b>Net cash used in investing activities</b>	<b>(117,861)</b>	<b>(165,620)</b>
<b>Cash flows from financing activities</b>		
Net decrease in deposit liabilities	(143,207)	(10,564)
Net increase (decrease) in short-term borrowings with original maturities of three months or less	(50,807)	109,845
Proceeds from short-term borrowings with original maturities of greater than three months		44,890
Net increase in retail repurchase agreements	35,199	21,650
Proceeds from other bank borrowings	550,897	635,840
Repayments of other bank borrowings	(436,385)	(608,595)
Proceeds from issuance of long-term debt	221,327	
Repayment of long-term debt	(126,000)	(110,000)
Excess tax benefits from share-based payment arrangements	259	567
Net proceeds from issuance of common stock	8,341	2,481
Common stock dividends	(40,480)	(50,282)
Decrease in cash overdraft	(9,098)	(6,786)
Other	(1,594)	(842)

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<b>Net cash provided by financing activities</b>	<b>8,452</b>	<b>28,204</b>
<b>Cash flows from discontinued operations-net cash provided by operating activities</b>		<b>6,846</b>
Net increase (decrease) in cash and equivalents and federal funds sold	(29,994)	17,119
Cash and equivalents and federal funds sold, beginning of period	257,301	208,947
<b>Cash and equivalents and federal funds sold, end of period</b>	<b>\$ 227,307</b>	<b>\$ 226,066</b>

See accompanying Notes to Consolidated Financial Statements for HEI.



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Hawaiian Electric Industries, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**(1) Basis of presentation**

The accompanying unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) for interim financial information, the instructions to SEC Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In preparing the financial statements, management is required 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 balance sheet and the reported amounts of revenues and expenses for the period. Actual results could differ significantly from those estimates. The accompanying unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in HEI's Form 10-K for the year ended December 31, 2006 and the unaudited consolidated financial statements and the notes thereto in HEI's Quarterly Report on SEC Form 10-Q for the quarter ended March 31, 2007.

In the opinion of HEI's management, the accompanying unaudited consolidated financial statements contain all material adjustments required by GAAP to present fairly the Company's financial position as of June 30, 2007 and December 31, 2006 and the results of its operations for the three and six months ended June 30, 2007 and 2006 and its cash flows for the six months ended June 30, 2007 and 2006. All such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q or other referenced material. Results of operations for interim periods are not necessarily indicative of results for the full year. When required, certain reclassifications are made to the prior period's consolidated financial statements to conform to the current presentation.

**Table of Contents****(2) Segment financial information**

(in thousands)	Electric Utility	Bank	Other	Total
<b>Three months ended June 30, 2007</b>				
Revenues from external customers	\$ 492,651	\$ 107,526	\$ 586	\$ 600,763
Intersegment revenues (eliminations)	61		(61)	
Revenues	492,712	107,526	525	600,763
Profit (loss)*	17,168	19,746	(9,572)	27,342
Income taxes (benefit)	6,518	7,164	(3,889)	9,793
Net income (loss)	10,650	12,582	(5,683)	17,549
<b>Six months ended June 30, 2007</b>				
Revenues from external customers	940,259	211,986	2,541	1,154,786
Intersegment revenues (eliminations)	131		(131)	
Revenues	940,390	211,986	2,410	1,154,786
Profit (loss)*	17,308	38,145	(18,724)	36,729
Income taxes (benefit)	6,205	13,967	(7,756)	12,416
Net income (loss)	11,103	24,178	(10,968)	24,313
Assets (at June 30, 2007)	\$ 3,128,278	\$ 6,817,246	\$ 12,032	\$ 9,957,556
<b>Three months ended June 30, 2006</b>				
Revenues from external customers	\$ 503,897	\$ 102,556	\$ (1,484)	\$ 604,969
Intersegment revenues (eliminations)	70		(70)	
Revenues	503,967	102,556	(1,554)	604,969
Profit (loss)*	28,109	26,159	(10,839)	43,429
Income taxes (benefit)	10,823	9,941	(4,559)	16,205
Net income (loss)	17,286	16,218	(6,280)	27,224
<b>Six months ended June 30, 2006</b>				
Revenues from external customers	978,883	202,560	(1,512)	1,179,931
Intersegment revenues (eliminations)	140		(140)	
Revenues	979,023	202,560	(1,652)	1,179,931
Profit (loss)*	62,206	53,174	(20,140)	95,240
Income taxes (benefit)	23,932	20,129	(8,382)	35,679
Net income (loss)	38,274	33,045	(11,758)	59,561
Assets (at June 30, 2006, including net assets of discontinued operations)	\$ 3,139,155	\$ 6,866,794	\$ 14,779	\$ 10,020,728

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\* Income (loss) before income taxes.

Intercompany electric sales of consolidated HECO to the bank and other segments are not eliminated because those segments would need to purchase electricity from another source if it were not provided by consolidated HECO, the profit on such sales is nominal and the elimination of electric sales revenues and expenses could distort segment operating income and net income.

Bank fees that ASB charges the electric utility and other segments are not eliminated because those segments would pay fees to another financial institution if they were to bank with another institution, the profit on such fees is nominal and the elimination of bank fee income and expenses could distort segment operating income and net income.

**Table of Contents****(3) Electric utility subsidiary**

For HECO's consolidated financial information, including its commitments and contingencies, see pages 15 through 38.

**(4) Bank subsidiary****Selected financial information**

American Savings Bank, F.S.B. and Subsidiaries

**Consolidated Statements of Income Data (unaudited)**

	Three months ended		Six months ended	
	June 30		June 30	
	2007	2006	2007	2006
<b>(in thousands)</b>				
<b>Interest and dividend income</b>				
Interest and fees on loans	\$ 60,093	\$ 57,323	\$ 120,374	\$ 112,476
Interest and dividends on investment and mortgage-related securities	30,428	30,870	58,593	60,947
	90,521	88,193	178,967	173,423
<b>Interest expense</b>				
Interest on deposit liabilities	20,832	17,001	41,570	32,394
Interest on other borrowings	18,581	18,308	36,987	35,470
	39,413	35,309	78,557	67,864
<b>Net interest income</b>	<b>51,108</b>	<b>52,884</b>	<b>100,410</b>	<b>105,559</b>
Provision for loan losses	1,200		1,200	
<b>Net interest income after provision for loan losses</b>	<b>49,908</b>	<b>52,884</b>	<b>99,210</b>	<b>105,559</b>
<b>Noninterest income</b>				
Fees from other financial services	6,885	6,742	13,386	13,182
Fee income on deposit liabilities	6,457	4,376	12,512	8,565
Fee income on other financial products	1,856	2,132	3,868	4,569
Other income	1,807	1,113	3,253	2,821
	17,005	14,363	33,019	29,137
<b>Noninterest expense</b>				
Compensation and employee benefits	18,164	17,476	36,560	35,313
Occupancy	5,341	4,490	10,289	8,953
Equipment	3,785	3,636	7,263	7,132
Services	7,895	4,124	16,253	7,841
Data processing	2,646	2,547	5,203	5,007
Other expense	9,336	8,815	18,516	17,276
	47,167	41,088	94,084	81,522

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<b>Income before income taxes</b>	<b>19,746</b>	<b>26,159</b>	<b>38,145</b>	<b>53,174</b>
<b>Income taxes</b>	<b>7,164</b>	<b>9,941</b>	<b>13,967</b>	<b>20,129</b>
<b>Net income</b>	<b>\$ 12,582</b>	<b>\$ 16,218</b>	<b>\$ 24,178</b>	<b>\$ 33,045</b>

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American Savings Bank, F.S.B. and Subsidiaries

**Consolidated Balance Sheet Data (unaudited)**

	June 30,	December 31,
(in thousands)	2007	2006
<b>Assets</b>		
Cash and equivalents	\$ 146,012	\$ 172,370
Federal funds sold	75,144	79,671
Available-for-sale investment and mortgage-related securities	2,301,360	2,367,427
Investment in stock of Federal Home Loan Bank of Seattle, at cost	97,764	97,764
Loans receivable, net	3,887,739	3,780,461
Other	223,072	223,666
Goodwill and other intangibles, net	86,155	87,140
	<b>\$ 6,817,246</b>	<b>\$ 6,808,499</b>
<b>Liabilities and stockholder's equity</b>		
Deposit liabilities - noninterest-bearing	\$ 649,455	\$ 648,915
Deposit liabilities - interest-bearing	3,782,886	3,926,633
Other borrowings	1,718,027	1,568,585
Other	105,226	104,470
	<b>6,255,594</b>	<b>6,248,603</b>
Common stock	324,634	323,154
Retained earnings	283,094	280,046
Accumulated other comprehensive loss, net of tax benefits	(46,076)	(43,304)
	<b>561,652</b>	<b>559,896</b>
	<b>\$ 6,817,246</b>	<b>\$ 6,808,499</b>

Other borrowings consisted of securities sold under agreements to repurchase and advances from the Federal Home Loan Bank (FHLB) of Seattle of \$971 million and \$747 million, respectively, as of June 30, 2007 and \$730 million and \$839 million, respectively, as of December 31, 2006.

As of June 30, 2007, ASB had commitments to borrowers for undisbursed loan funds, loan commitments and unused lines and letters of credit of \$1.1 billion.

**(5) Retirement benefits**

For the first six months of 2007, HECO contributed \$4.2 million, ASB contributed \$0.9 million and HEI contributed less than \$0.1 million to their respective retirement benefit plans, compared to \$5.1 million, \$1.5 million and \$0.1 million, respectively, in the first six months of 2006. The Company's current estimate of contributions to its retirement benefit plans in 2007 is \$13.1 million (including \$12.1 million by HECO, \$0.9 million by ASB and \$0.1 million by HEI), compared to contributions of \$12.9 million in 2006. In addition, the Company expects to pay directly \$1.7 million of benefits in 2007, compared to \$1.2 million paid in 2006.

The components of net periodic benefit cost were as follows:

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	Three months ended June 30				Six months ended June 30			
	Pension benefits		Other benefits		Pension benefits		Other benefits	
	2007	2006	2007	2006	2007	2006	2007	2006
<b>(in thousands)</b>								
Service cost	\$ 7,751	\$ 8,236	\$ 1,209	\$ 1,278	\$ 15,504	\$ 16,327	\$ 2,440	\$ 2,549
Interest cost	14,444	13,645	2,774	2,578	28,864	27,121	5,634	5,310
Expected return on plan assets	(17,098)	(18,089)	(2,404)	(2,493)	(34,200)	(35,842)	(4,702)	(4,959)
Amortization of unrecognized transition obligation	1	1	784	785	2	2	1,569	1,569
Amortization of prior service cost (gain)	(49)	14	4	4	(98)	(142)	7	7
Recognized actuarial loss (gain)	2,835	2,917		(18)	5,690	6,028		206
<b>Net periodic benefit cost</b>	<b>\$ 7,884</b>	<b>\$ 6,724</b>	<b>\$ 2,367</b>	<b>\$ 2,134</b>	<b>\$ 15,762</b>	<b>\$ 13,494</b>	<b>\$ 4,948</b>	<b>\$ 4,682</b>

The Company recorded retirement benefits expense of \$17 million and \$14 million in the first six months of 2007 and 2006, respectively. The electric utilities charged a portion of the net periodic benefit costs to plant. Also, in an

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interim order issued in April 2007, the amount of HELCO's net periodic benefit costs to be recovered in rates was established. Thus, any costs determined under SFAS No. 87, as amended, that are over/under this amount are charged/credited to a regulatory asset. Further, under the interim order, a regulatory asset (representing HELCO's prepaid pension asset as of December 31, 2006 prior to the adoption of SFAS No. 158) was allowed to be recovered (and is being amortized) over a period of five years. Retirement benefits expense for HELCO for the second quarter of 2007 was \$1.3 million, but would have been \$0.9 million if the pension and postretirement benefits other than pensions (OPEB) tracking mechanisms had not been adopted in the April 2007 interim order issued in HELCO's 2006 test year rate case.

Also, see Note 4, Retirement benefits, of HELCO's Notes to Consolidated Financial Statements.

**(6) Share-based compensation**

Under the 1987 Stock Option and Incentive Plan, as amended (SOIP), HEI may issue an aggregate of 9.3 million shares of common stock (4,798,822 shares available for issuance under outstanding and future grants and awards as of June 30, 2007) to officers and key employees as incentive stock options, nonqualified stock options (NQSOs), restricted stock, stock appreciation rights (SARs), stock payments or dividend equivalents. HEI has issued new shares for NQSOs, restricted stock (nonvested stock), SARs and dividend equivalents under the SOIP. All information presented has been adjusted for the 2-for-1 stock split in June 2004.

For the NQSOs and SARs, the exercise price of each NQSO or SAR generally equaled the fair market value of HEI's stock on or near the date of grant. NQSOs, SARs and related dividend equivalents issued in the form of stock awarded prior to and through 2004 generally become exercisable in installments of 25% each year for four years, and expire if not exercised ten years from the date of the grant. The 2005 SARs awards, which have a ten year exercise life, generally become exercisable at the end of four years (i.e., cliff vesting) with the related dividend equivalents issued in the form of stock on an annual basis. Accelerated vesting is provided in the event of a change-in-control or upon retirement. NQSOs and SARs compensation expense has been recognized in accordance with the fair value-based measurement method of accounting. The estimated fair value of each NQSO and SAR grant was calculated on the date of grant using a Binomial Option Pricing Model.

Restricted stock grants generally become unrestricted three to five years after the date of grant and restricted stock compensation expense has been recognized in accordance with the fair value-based measurement method of accounting. Dividends on restricted stock are paid quarterly in cash.

The Company's share-based compensation expense and related income tax benefit (including a valuation allowance due to limits on the deductibility of executive compensation) are as follows:

(\$ in millions)	Three months ended		Six months ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Share-based compensation expense <sup>1</sup>	0.4	0.3	0.7	0.9
Income tax benefit	0.1	0.3	0.2	0.5

<sup>1</sup> The Company has not capitalized any share-based compensation cost. For all share-based compensation, the estimated forfeiture rate is 1.3%.



**Table of Contents****Nonqualified stock options**

Information about HEI's NQSOs is summarized as follows:

June 30, 2007		Outstanding & Exercisable		Weighted-
		Weighted-		Weighted-
		average		average
Year of	Range of	remaining		exercise
grant	exercise prices	Number of	contractual life	price
1998	\$ 20.50	6,000	0.8	\$ 20.50
1999	17.61 -17.63	48,300	2.0	17.62
2000	14.74	52,000	2.8	14.74
2001	17.96	83,000	3.8	17.96
2002	21.68	134,000	4.6	21.68
2003	20.49	280,500	5.7	20.49
	\$ 14.74 -21.68	603,800	4.6	\$ 19.68

As of December 31, 2006, NQSOs outstanding totaled 660,000, with a weighted-average exercise price of \$19.68. As of June 30, 2007, all NQSO shares outstanding were exercisable and had an aggregate intrinsic value (including dividend equivalents) of \$4.7 million.

NQSO activity and statistics are summarized as follows:

(\$ in thousands, except prices)	Three months ended		Six months ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Shares granted				
Shares forfeited				
Shares expired				
Shares vested	77,500	197,500	79,000	197,500
Aggregate fair value of vested shares	\$ 343	\$ 911	\$ 350	\$ 911
Shares exercised	36,700	110,500	56,200	116,500
Weighted-average exercise price	\$ 18.77	\$ 21.52	\$ 19.70	\$ 21.30
Cash received from exercise	\$ 689	\$ 2,378	\$ 1,107	\$ 2,482
Intrinsic value of shares exercised <sup>1</sup>	\$ 433	\$ 1,064	\$ 575	\$ 1,174
Tax benefit realized for the deduction of exercises	\$ 169	\$ 414	\$ 224	\$ 457
Dividend equivalent shares distributed under Section 409A		2,904	21,892	43,213
Weighted-average Section 409A distribution price		\$ 26.68	\$ 26.15	\$ 26.27
Intrinsic value of shares distributed under Section 409A		\$ 77	\$ 572	\$ 1,135
Tax benefit realized for Section 409A distributions		\$ 30	\$ 223	\$ 442

<sup>1</sup> Intrinsic value is the amount by which the fair market value of the underlying stock and the related dividend equivalents exceeds the exercise price of the option.

As of June 30, 2007, all NQSOs were vested.

**Stock appreciation rights**

Information about HEI's SARs is summarized as follows:

June 30, 2007		Outstanding	Weighted-	Weighted-	Number	Exercisable	Weighted-	Weighted-
Year of	Range of	Number	average	average	of shares	average	average	average
grant	exercise prices	of shares underlying SARs	remaining	exercise	underlying	remaining	exercise	exercise
			contractual life	price	SARs	contractual life		price
2004	\$ 26.02	325,000	4.6	\$ 26.02	280,000	4.3	\$ 26.02	
2005	26.18	550,000	6.0	26.18	166,000	1.9	26.18	
	\$ 26.02							
	26.18	875,000	5.5	\$ 26.12	446,000	3.4	\$ 26.08	

As of December 31, 2006, the shares underlying SARs outstanding totaled 879,000, with a weighted-average exercise price of \$26.12. As of June 30, 2007, the SARs outstanding and the SARs exercisable (including dividend equivalents) had no intrinsic value.

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SARs activity and statistics are summarized as follows:

(\$ in thousands, except prices)	Three months ended		Six months ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Shares granted				
Shares forfeited				
Shares expired				
Shares vested	45,000	313,750	51,000	313,750
Aggregate fair value of vested shares	\$ 234	\$ 1,749	\$ 269	\$ 1,749
Shares exercised			4,000	
Weighted-average exercise price			\$ 26.18	
Cash received from exercise				
Intrinsic value of shares exercised <sup>1</sup>			\$ 3	
Tax benefit realized for the deduction of exercises			\$ 1	
Dividend equivalent shares distributed under Section 409A		7,333	23,760	28,505
Weighted-average Section 409A distribution price		\$ 26.71	\$ 26.15	\$ 26.36
Intrinsic value of shares distributed under Section 409A		\$ 196	\$ 621	\$ 751
Tax benefit realized for Section 409A distributions		\$ 76	\$ 242	\$ 292

<sup>1</sup> Intrinsic value is the amount by which the fair market value of the underlying stock and the related dividend equivalents exceeds the exercise price of the right.

As of June 30, 2007, there was \$0.8 million of total unrecognized compensation cost related to SARs and that cost is expected to be recognized over a weighted average period of 1.7 years.

**Section 409A modification**

As a result of the changes enacted in Section 409A of the Internal Revenue Code of 1986, as amended (Section 409A), for the six months ended June 30, 2007 and 2006, a total of 45,652 and 71,719 dividend equivalent shares for NQSO and SAR grants were distributed to SOIP participants, respectively. Section 409A, which amended the rules on deferred compensation, required the Company to change the way certain affected dividend equivalents are paid in order to avoid significant adverse tax consequences to the SOIP participants. Generally, dividend equivalents subject to Section 409A will be paid within 2 1/2 months after the end of the calendar year. Upon retirement, an SOIP participant may elect to take distributions of dividend equivalents subject to Section 409A at the time of retirement or at the end of the calendar year.

**Restricted stock**

As of December 31, 2006, restricted stock shares outstanding totaled 91,800, with a weighted-average grant date fair value of \$25.68. As of June 30, 2007, restricted stock shares outstanding totaled 142,200, with a weighted-average grant date fair value of \$26.16. The grant date fair value of a grant of a restricted stock share is the closing price of HEI common stock on the date of grant.

During the first six months of 2007, 16,000 restricted stock shares vested, no restricted stock shares were forfeited, and 66,400 shares of restricted stock with a grant date fair market value of \$1.7 million were granted. During the second quarter of 2007, 16,000 restricted stock shares vested and 57,700 shares of restricted stock with a grant date fair market value of \$1.5 million were granted. For the quarter and six months ended June 30, 2006, no restricted stock shares vested or were forfeited and 60,800 shares with a grant date fair market value of \$1.6 million were granted. The tax benefit realized for the tax deductions from restricted stock was \$0.2 million for the first six months of 2007 and not significant for the first six months of 2006.

As of June 30, 2007, there was \$2.9 million of total unrecognized compensation cost related to nonvested restricted stock. The cost is expected to be recognized over a weighted-average period of 3.3 years.

**(7) Commitments and contingencies**

See Note 4, Bank subsidiary, above and Note 5, Commitments and contingencies, of HECO's Notes to Consolidated Financial Statements.

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### **(8) Cash flows**

#### **Supplemental disclosures of cash flow information**

For the six months ended June 30, 2007 and 2006, the Company paid interest to non-affiliates amounting to \$110 million and \$95 million, respectively.

For the six months ended June 30, 2007 and 2006, the Company paid income taxes amounting to \$3 million and \$4 million, respectively.

#### **Supplemental disclosures of noncash activities**

Noncash increases in common stock for director and officer compensatory plans of the Company were \$1.7 million and \$1.5 million for the six months ended June 30, 2007 and 2006, respectively.

Under the HEI Dividend Reinvestment and Stock Purchase Plan (DRIP), common stock dividends reinvested by shareholders in HEI common stock in noncash transactions amounted to \$10.2 million and nil for the six months ended June 30, 2007 and 2006, respectively. From March 23, 2004 to March 5, 2007, HEI satisfied the requirements of the HEI DRIP and the Hawaiian Electric Industries Retirement Savings Plan (HEIRSP) by acquiring for cash its common shares through open market purchases rather than the issuance of additional shares. On March 6, 2007, it began satisfying those requirements by the issuance of additional shares.

### **(9) Recent accounting pronouncements and interpretations**

#### **Fair value measurements**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies to fair value measurements that are already required or permitted under existing accounting pronouncements with some exceptions. SFAS No. 157 retains the exchange price notion in defining fair value and clarifies that the exchange price is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability. It emphasizes that fair value is a market-based, not an entity-specific, measurement based upon the assumptions that market participants would use in pricing an asset or liability. As a basis for considering assumptions in fair value measurements, SFAS No. 157 establishes a hierarchy that gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). SFAS No. 157 expands disclosures about the use of fair value, including disclosure of the level within the hierarchy in which the fair value measurements fall and the effect of the measurements on earnings (or changes in net assets) for the period. SFAS No. 157 must be adopted by the first quarter of the fiscal year beginning after November 15, 2007. The Company plans to adopt SFAS No. 157 on January 1, 2008. Management has not yet determined what impact, if any, the adoption of SFAS No. 157 will have on the Company's financial statements.

#### **The fair value option for financial assets and financial liabilities**

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which should improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 must be adopted by January 1, 2008. The Company plans to adopt SFAS No. 159 on January 1, 2008. Management has not yet determined what impact, if any, the adoption of SFAS No. 159 will have on the Company's financial statements.

#### **Income Tax Benefits of Dividends on Share-Based Payment Awards**

In June 2007, the FASB ratified the EITF consensus reached on EITF Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards." The consensus applies to share-based payment arrangements in which the employee receives dividends on the award during the vesting period, the dividend payment results in a tax deduction, and the employer thereby realizes a tax benefit during the vesting period (e.g., restricted stock awards issued by the Company). Under SFAS No. 123R, dividends paid during the vesting period on share-based payments that are expected to vest are charged to retained earnings because the compensation cost



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already reflects the expected value of those dividends, which are included in the grant date fair value of the award, but dividends on awards that do not vest are recognized as additional compensation cost. The consensus requires the tax benefit received on dividends associated with share-based awards that are charged to retained earnings to be recorded in additional paid-in capital and included in the pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards. A tax benefit recognized from a dividend on an award that is subsequently forfeited or is no longer expected to vest (and that is therefore reclassified as additional compensation expense) would be reclassified to the income statement if sufficient excess tax benefits are available in the pool of excess tax benefits in additional paid-in capital on the date of the reclassification. The consensus is effective for the tax benefits of dividends declared in fiscal years beginning after December 15, 2007. The Company will adopt this consensus on January 1, 2008 and the adoption is not expected to have an impact on the Company's financial statements.

**(10) Income taxes**

In June 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, which prescribes a more-likely-than-not recognition threshold and measurement attribute (the largest amount of benefit that is greater than 50% likely of being realized upon ultimate resolution with tax authorities) for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 in the first quarter of 2007. The impact to the Company was a reclassification of certain deferred tax liabilities to a liability for tax uncertainties and a charge of \$0.2 million to retained earnings as of January 1, 2007 for the cumulative effect of adoption of FIN 48.

In general, prior to January 1, 2007, the Company (except for ASB) recorded known interest and penalties on income taxes in Interest expense other than bank (in Interest and other charges in HECO's consolidated statements of income) and ASB recorded known interest and penalties on income taxes in Expenses Bank (in Other expense in ASB's consolidated statements of income). Since the adoption of FIN 48, the electric utilities and ASB record all (potential and known) interest and penalties on income taxes in Interest and other charges and Other expense, respectively, but the Company records such amounts in Interest expense other than on deposit liabilities and other bank borrowings. For the first six months of 2006, interest accrued on income taxes was insignificant. For the first six months of 2007, \$0.4 million of interest on income taxes was reflected in Interest expense other than on deposit liabilities and bank borrowings.

As of January 1, 2007, the total amount of accrued interest and penalties related to uncertain tax positions and recognized on the balance sheet was \$2.0 million.

As of January 1, 2007, the total amount of unrecognized tax benefits was \$11 million, and of this amount, \$0.6 million, if recognized, would affect the Company's effective tax rate. Management concluded that it is reasonably possible that the unrecognized tax benefits will significantly decrease within the next 12 months due to the resolution of issues under examination by the Internal Revenue Service. Management cannot estimate the range of the reasonably possible change.

Tax years 2003 to 2006 currently remain subject to examination by the Internal Revenue Service and Department of Taxation of the State of Hawaii. HEIII, which owns leveraged lease investments in other states, is also subject to examination by those state tax authorities for tax years 2003 to 2006.

The Company's effective tax rate for the first six months of 2007 was 34%, compared to an effective tax rate for the first six months of 2006 of 37%. The lower effective tax rate was primarily due to the impact of state tax credits (including the acceleration of the state tax credits associated with the write-off of a portion of CT-4 and CT-5 costs) recognized against a smaller income tax expense base.

**Table of Contents****(11) Sale of shares in Hoku Scientific, Inc.**

HEI Properties, Inc. (HEIPI) held shares of Hoku Scientific, Inc. (Hoku), a materials science company focused on clean energy technologies. Shares of Hoku began trading on the Nasdaq Stock Market on August 5, 2005 and since then HEIPI had classified its Hoku shares as trading securities, carried at fair value with changes in fair value recorded in earnings. HEIPI began selling Hoku stock in February 2006 when HEIPI's lock-up agreement expired. In the first six months of 2006, HEIPI recognized a \$1.6 million loss (unrealized and realized, net of taxes) on its Hoku shares. As of December 31, 2006, HEIPI had carried its remaining investment in Hoku shares at \$1.2 million. In January 2007, HEIPI sold its remaining Hoku shares for a net after-tax gain of \$0.9 million.

**(12) Credit agreement**

Effective April 3, 2006, HEI entered into a revolving unsecured credit agreement establishing a line of credit facility of \$100 million, with a letter of credit sub-facility, expiring on March 31, 2011, with a syndicate of eight financial institutions. Any draws on the facility bear interest, at the option of HEI, at either the Adjusted LIBO Rate plus 50 basis points or the greater of (a) the Prime Rate and (b) the sum of the Federal Funds Rate plus 50 basis points, as defined in the agreement. The annual fee is 10 basis points on the undrawn commitment amount. The agreement contains provisions for revised pricing in the event of a ratings change. For example, a ratings downgrade of HEI's Senior Debt Rating (e.g., from BBB/Baa2 to BBB-/Baa3 by S&P and Moody's, respectively) would result in a commitment fee increase of 2.5 basis points and an interest rate increase of 10 basis points on any drawn amounts. On the other hand, a ratings upgrade (e.g., from BBB/Baa2 to BBB+/Baa1) would result in a commitment fee decrease of 2 basis points and an interest rate decrease of 10 basis points on any drawn amounts. The agreement does not contain clauses that would affect access to the lines by reason of a ratings downgrade, nor does it have a broad material adverse change clause. However, the agreement does contain customary conditions which must be met in order to draw on it, such as the accuracy of certain of its representations at the time of a draw and compliance with its covenants (such as covenants preventing its subsidiaries from entering into agreements that restrict the ability of the subsidiaries to pay dividends to, or to repay borrowings from, HEI). In addition to customary defaults, HEI's failure to maintain its financial ratio, as defined in the agreement, or meet other requirements will result in an event of default. For example, under the agreement, it is an event of default if HEI fails to maintain a nonconsolidated Capitalization Ratio (funded debt) of 50% or less (ratio of 27% as of June 30, 2007, as calculated under the agreement) and Consolidated Net Worth of \$850 million (Net Worth of \$1.3 billion as of June 30, 2007, as calculated under the agreement), if there is a Change in Control of HEI, if any event or condition occurs that results in any Material Indebtedness of HEI being subject to acceleration prior to its scheduled maturity, if any Material Subsidiary Indebtedness actually becomes due prior to its scheduled maturity, or if ASB fails to remain well capitalized and to maintain specified minimum capital ratios. HEI's syndicated credit facility is maintained to support the issuance of commercial paper, but may also be drawn to make investments in and advances to its subsidiaries, and for the Company's working capital and general corporate purposes. As of August 1, 2007, the \$100 million credit facility remained undrawn.

See Note 10 of HECO's Notes to Consolidated Financial Statements for a discussion of HECO's credit facility.



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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Statements of Income (unaudited)**

	Three months ended		Six months ended	
	June 30		June 30	
	2007	2006	2007	2006
<b>(in thousands, except for ratio of earnings to fixed charges)</b>				
<b>Operating revenues</b>	<b>\$ 491,249</b>	<b>\$ 503,350</b>	<b>\$ 938,046</b>	<b>\$ 977,321</b>
<b>Operating expenses</b>				
Fuel oil	167,121	192,314	327,050	367,652
Purchased power	133,727	122,438	245,243	240,158
Other operation	53,643	47,934	100,836	89,953
Maintenance	29,869	22,382	57,205	39,434
Depreciation	34,272	32,542	68,539	65,075
Taxes, other than income taxes	44,903	46,218	87,450	90,741
Income taxes	6,492	11,020	10,998	24,244
	470,027	474,848	897,321	917,257
<b>Operating income</b>	<b>21,222</b>	<b>28,502</b>	<b>40,725</b>	<b>60,064</b>
<b>Other income</b>				
Allowance for equity funds used during construction	1,202	1,588	2,434	3,136
Other, net	1,049	521	(5,149)	1,430
	2,251	2,109	(2,715)	4,566
<b>Income before interest and other charges</b>	<b>23,473</b>	<b>30,611</b>	<b>38,010</b>	<b>64,630</b>
<b>Interest and other charges</b>				
Interest on long-term debt	11,390	10,776	22,886	21,554
Amortization of net bond premium and expense	646	543	1,192	1,086
Other interest charges	874	2,226	3,015	4,139
Allowance for borrowed funds used during construction	(586)	(719)	(1,184)	(1,421)
Preferred stock dividends of subsidiaries	229	229	458	458
	12,553	13,055	26,367	25,816
<b>Income before preferred stock dividends of HECO</b>	<b>10,920</b>	<b>17,556</b>	<b>11,643</b>	<b>38,814</b>
Preferred stock dividends of HECO	270	270	540	540
<b>Net income for common stock</b>	<b>\$ 10,650</b>	<b>\$ 17,286</b>	<b>\$ 11,103</b>	<b>\$ 38,274</b>
Ratio of earnings to fixed charges (SEC method)			1.58	3.16

HEI owns all the common stock of HECO. Therefore, per share data with respect to shares of common stock of HECO are not meaningful.

See accompanying Notes to Consolidated Financial Statements for HECO.



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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Balance Sheets (unaudited)**

	June 30,	December 31,
(in thousands, except par value)	2007	2006
<b>Assets</b>		
<b>Utility plant, at cost</b>		
Land	\$ 35,223	\$ 35,242
Plant and equipment	4,054,001	4,002,929
Less accumulated depreciation	(1,608,646)	(1,558,913)
Plant acquisition adjustment, net	67	93
Construction in progress	106,605	95,619
<b>Net utility plant</b>	<b>2,587,250</b>	<b>2,574,970</b>
<b>Current assets</b>		
Cash and equivalents	4,861	3,859
Customer accounts receivable, net	132,737	125,524
Accrued unbilled revenues, net	83,198	92,195
Other accounts receivable, net	5,693	4,423
Fuel oil stock, at average cost	88,460	64,312
Materials and supplies, at average cost	33,594	30,540
Other	8,805	9,695
<b>Total current assets</b>	<b>357,348</b>	<b>330,548</b>
<b>Other long-term assets</b>		
Regulatory assets	132,605	112,349
Unamortized debt expense	16,037	13,722
Other	35,038	31,545
<b>Total other long-term assets</b>	<b>183,680</b>	<b>157,616</b>
	<b>\$ 3,128,278</b>	<b>\$ 3,063,134</b>
<b>Capitalization and liabilities</b>		
<b>Capitalization</b>		
Common stock, \$6 2/3 par value, authorized 50,000 shares; outstanding 12,806 shares	\$ 85,387	\$ 85,387
Premium on capital stock	299,214	299,214
Retained earnings	710,735	700,252
Accumulated other comprehensive loss, net of income tax benefits	(104,776)	(126,650)
<b>Common stock equity</b>	<b>990,560</b>	<b>958,203</b>
Cumulative preferred stock not subject to mandatory redemption	34,293	34,293
Long-term debt, net	863,824	766,185
<b>Total capitalization</b>	<b>1,888,677</b>	<b>1,758,681</b>
<b>Current liabilities</b>		
Short-term borrowings nonaffiliates	52,626	113,107
Accounts payable	102,379	102,512

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Interest and preferred dividends payable	13,949	10,645
Taxes accrued	137,436	152,182
Other	34,877	43,120
<b>Total current liabilities</b>	<b>341,267</b>	<b>421,566</b>
<b>Deferred credits and other liabilities</b>		
Deferred income taxes	103,359	118,055
Regulatory liabilities	251,198	240,619
Unamortized tax credits	57,854	57,879
Other	203,979	189,606
Total deferred credits and other liabilities	616,390	606,159
Contributions in aid of construction	281,944	276,728
	\$ 3,128,278	\$ 3,063,134

See accompanying Notes to Consolidated Financial Statements for HECO.

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Statements of Changes in Stockholders' Equity (unaudited)**

	Common stock		Premium	Accumulated		Total
	Shares	Amount	on capital stock	Retained earnings	other comprehensive loss	
(in thousands, except per share amounts)						
<b>Balance, December 31, 2006</b>	<b>12,806</b>	<b>\$ 85,387</b>	<b>\$ 299,214</b>	<b>\$ 700,252</b>	<b>\$ (126,650)</b>	<b>\$ 958,203</b>
Comprehensive income:						
Net income				11,103		11,103
Defined benefit retirement plans – amortization of net loss, prior service cost and transition obligation included periodic benefit cost, net of taxes of \$2,337					3,669	3,669
<b>Comprehensive income</b>				<b>11,103</b>	<b>3,669</b>	<b>14,772</b>
Adjustment to initially apply a PUC D&O related to defined benefit retirement plans, net of taxes of \$11,595					18,205	18,205
Adjustment to initially apply FIN 48				(620)		(620)
<b>Balance, June 30, 2007</b>	<b>12,806</b>	<b>\$ 85,387</b>	<b>\$ 299,214</b>	<b>\$ 710,735</b>	<b>\$ (104,776)</b>	<b>\$ 990,560</b>
<b>Balance, December 31, 2005</b>	<b>12,806</b>	<b>\$ 85,387</b>	<b>\$ 299,214</b>	<b>\$ 654,686</b>	<b>\$ (28)</b>	<b>\$ 1,039,259</b>
Net income				38,274		38,274
Common stock dividends				(29,381)		(29,381)
<b>Balance, June 30, 2006</b>	<b>12,806</b>	<b>\$ 85,387</b>	<b>\$ 299,214</b>	<b>\$ 663,579</b>	<b>\$ (28)</b>	<b>\$ 1,048,152</b>

See accompanying Notes to Consolidated Financial Statements for HECO.

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Statements of Cash Flows (unaudited)**

Six months ended June 30 (in thousands)	2007	2006
<b>Cash flows from operating activities</b>		
Income before preferred stock dividends of HECO	\$ 11,643	\$ 38,814
Adjustments to reconcile income before preferred stock dividends of HECO to net cash provided by operating activities		
Depreciation of property, plant and equipment	68,539	65,075
Other amortization	3,836	3,801
Writedown of utility plant	11,701	
Deferred income taxes	(12,484)	(6,912)
Tax credits, net	1,116	2,459
Allowance for equity funds used during construction	(2,434)	(3,136)
Changes in assets and liabilities		
Decrease (increase) in accounts receivable	(8,483)	6,404
Decrease in accrued unbilled revenues	8,997	2,966
Increase in fuel oil stock	(24,148)	(28,024)
Increase in materials and supplies	(3,054)	(3,150)
Increase in regulatory assets	(1,628)	(1,587)
Decrease in accounts payable	(133)	(206)
Increase (decrease) in taxes accrued	(14,746)	9,723
Changes in other assets and liabilities	7,262	6,979
<b>Net cash provided by operating activities</b>	<b>45,984</b>	<b>93,206</b>
<b>Cash flows from investing activities</b>		
Capital expenditures	(77,769)	(91,394)
Contributions in aid of construction	7,577	10,622
Other		193
<b>Net cash used in investing activities</b>	<b>(70,192)</b>	<b>(80,579)</b>
<b>Cash flows from financing activities</b>		
Common stock dividends		(29,381)
Preferred stock dividends	(540)	(540)
Proceeds from issuance of long-term debt	221,327	
Repayment of long-term debt	(126,000)	
Net increase (decrease) in short-term borrowings from		
nonaffiliates and affiliate with original maturities of three months or less	(60,481)	27,311
Decrease in cash overdraft	(9,096)	(6,786)
<b>Net cash provided by (used in) financing activities</b>	<b>25,210</b>	<b>(9,396)</b>
Net increase in cash and equivalents	1,002	3,231
Cash and equivalents, beginning of period	3,859	143
<b>Cash and equivalents, end of period</b>	<b>\$ 4,861</b>	<b>\$ 3,374</b>

See accompanying Notes to Consolidated Financial Statements for HECO.



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Hawaiian Electric Company, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**(1) Basis of presentation**

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP for interim financial information, the instructions to SEC Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In preparing the financial statements, management is required 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 balance sheet and the reported amounts of revenues and expenses for the period. Actual results could differ significantly from those estimates. The accompanying unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto incorporated by reference in HECO's Form 10-K for the year ended December 31, 2006 and the unaudited consolidated financial statements and the notes thereto in HECO's Quarterly Report on SEC Form 10-Q for the quarter ended March 31, 2007.

In the opinion of HECO's management, the accompanying unaudited consolidated financial statements contain all material adjustments required by GAAP to present fairly the financial position of HECO and its subsidiaries as of June 30, 2007 and December 31, 2006 and the results of their operations for the three and six months ended June 30, 2007 and 2006 and their cash flows for the six months ended June 30, 2007 and 2006. All such adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q or other referenced material. Results of operations for interim periods are not necessarily indicative of results for the full year. When required, certain reclassifications are made to the prior period's consolidated financial statements to conform to the current presentation.

**(2) Unconsolidated variable interest entities**

**HECO Capital Trust III**

HECO Capital Trust III (Trust III) was created and exists for the exclusive purposes of (i) issuing in March 2004 2,000,000 6.50% Cumulative Quarterly Income Preferred Securities, Series 2004 (2004 Trust Preferred Securities) (\$50 million aggregate liquidation preference) to the public and trust common securities (\$1.5 million aggregate liquidation preference) to HECO, (ii) investing the proceeds of these trust securities in 2004 Debentures issued by HECO in the principal amount of \$31.5 million and issued by each of Hawaii Electric Light Company, Inc. (HELCO) and Maui Electric Company, Limited (MECO) in the respective principal amounts of \$10 million, (iii) making distributions on the trust securities and (iv) engaging in only those other activities necessary or incidental thereto. The 2004 Trust Preferred Securities are mandatorily redeemable at the maturity of the underlying debt on March 18, 2034, which maturity may be extended to no later than March 18, 2053; and are redeemable at the issuer's option without premium beginning on March 18, 2009. The 2004 Debentures, together with the obligations of HECO, HELCO and MECO under an expense agreement and HECO's obligations under its trust guarantee and its guarantee of the obligations of HELCO and MECO under their respective debentures, are the sole assets of Trust III. Trust III has at all times been an unconsolidated subsidiary of HECO. Since HECO, as the common security holder, does not absorb the majority of the variability of Trust III, HECO is not the primary beneficiary and does not consolidate Trust III in accordance with FIN 46R, Consolidation of Variable Interest Entities. Trust III's balance sheets as of June 30, 2007 and December 31, 2006 each consisted of \$51.5 million of 2004 Debentures; \$50.0 million of 2004 Trust Preferred Securities; and \$1.5 million of trust common securities. Trust III's income statements for six months ended June 30, 2007 and 2006 each consisted of \$1.7 million of interest income received from the 2004 Debentures; \$1.6 million of distributions to holders of the Trust Preferred Securities; and \$0.1 million of common dividends on the trust common securities to HECO. So long as the 2004 Trust Preferred Securities are outstanding, HECO is not entitled to receive any funds from Trust III other than pro rata distributions, subject to certain subordination provisions, on the trust common securities. In the event of a default by HECO in the performance of its obligations under the 2004 Debentures or under its Guarantees, or in the event HECO, HELCO or



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MECO elect to defer payment of interest on any of their respective 2004 Debentures, then HECO will be subject to a number of restrictions, including a prohibition on the payment of dividends on its common stock.

### **Purchase power agreements**

As of June 30, 2007, HECO and its subsidiaries had six PPAs for a total of 540 megawatts (MW) of firm capacity, and other PPAs with smaller IPPs and Schedule Q providers that supplied as-available energy. Approximately 91% of the 540 MW of firm capacity is under PPAs, entered into before December 31, 2003, with AES Hawaii, Inc. (AES Hawaii), Kalaeloa Partners, L.P. (Kalaeloa), Hamakua Energy Partners, L.P. (HEP) and HPOWER. Purchases from all IPPs for the six months ended June 30, 2007 totaled \$245 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling \$71 million, \$82 million, \$32 million and \$18 million, respectively. The primary business activities of these IPPs are the generation and sale of power to HECO and its subsidiaries (and municipal waste disposal in the case of HPOWER). Current financial information about the size, including total assets and revenues, for many of these IPPs is not publicly available.

Under FIN 46R, an enterprise with an interest in a variable interest entity (VIE) or potential VIE created before December 31, 2003 (and not thereafter materially modified) is not required to apply FIN 46R to that entity if the enterprise is unable to obtain, after making an exhaustive effort, the necessary information.

HECO reviewed its significant PPAs and determined in 2004 that the IPPs had no contractual obligation to provide such information. In March 2004, HECO and its subsidiaries sent letters to all of their IPPs, except the Schedule Q providers, requesting the information that they need to determine the applicability of FIN 46R to the respective IPP, and subsequently contacted most of the IPPs to explain and repeat its request for information. (HECO and its subsidiaries excluded their Schedule Q providers from the scope of FIN 46R because their variable interest in the provider would not be significant to the utilities and they did not participate significantly in the design of the provider.) Some of the IPPs provided sufficient information for HECO to determine that the IPP was not a VIE, or was either a business or governmental organization (HPOWER) as defined under FIN 46R, and thus excluded from the scope of FIN 46R. Other IPPs, including the three largest, declined to provide the information necessary for HECO to determine the applicability of FIN 46R, and HECO was unable to apply FIN 46R to these IPPs.

As required under FIN 46R, HECO has continued after 2004 its efforts to obtain from the IPPs the information necessary to make the determinations required under FIN 46R. In January 2005, 2006 and 2007, HECO and its subsidiaries again sent letters to the IPPs that were not excluded from the scope of FIN 46R, requesting the information required to determine the applicability of FIN 46R to the respective IPP. All of these IPPs again declined to provide the necessary information, except that Kalaeloa (see below) and Kaheawa Wind Power, LLC (KWP) have now provided their information. Management has concluded that MECO does not have to consolidate KWP (which began selling power to MECO in June 2006 from its 30 MW windfarm) as MECO does not have a variable interest in KWP because the PPA does not require MECO to absorb variability of KWP.

If the requested information is ultimately received from the other IPPs, a possible outcome of future analysis is the consolidation of one or more of such IPPs in HECO's consolidated financial statements. The consolidation of any significant IPP could have a material effect on HECO's consolidated financial statements, including the recognition of a significant amount of assets and liabilities, and, if such a consolidated IPP were operating at a loss and had insufficient equity, the potential recognition of such losses. If HECO and its subsidiaries determine they are required to consolidate the financial statements of such an IPP and the consolidation has a material effect, HECO and its subsidiaries would retrospectively apply FIN 46R in accordance with SFAS No. 154, Accounting Changes and Error Corrections.

Kalaeloa Partners, L.P. In October 1988, HECO entered into a PPA with Kalaeloa, subsequently approved by the PUC, which provided that HECO would purchase 180 MW of firm capacity for a period of 25 years beginning in May 1991. In October 2004, HECO and Kalaeloa entered into amendments to the PPA, subsequently approved by the PUC, which together effectively increased the firm capacity from 180 MW to 208 MW. The energy payments that HECO makes to Kalaeloa include: 1) a fuel component, with a fuel price adjustment based on the cost of low sulfur fuel oil, 2) a fuel additives cost component and 3) a non-fuel component, with an adjustment based on changes in the Gross National Product Implicit Price Deflator. The capacity payments that HECO makes to Kalaeloa are fixed in accordance with the PPA.

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Kalaeloa is a Delaware limited partnership formed on October 13, 1988 for the purpose of designing, constructing, owning and operating a 200 MW cogeneration facility on Oahu, which includes two 75 MW oil-fired combustion turbines, two waste heat recovery steam generators, a 50 MW turbine generator and other electrical, mechanical and control equipment. The two combustion turbines were upgraded during 2004 resulting in an increase in the facility's nominal output rating to approximately 220 MW. Kalaeloa has a PPA with HECO (described above) and a steam delivery contract with another customer, the term of which coincides with the PPA. The facility has been certified by the Federal Energy Regulatory Commission as a Qualifying Facility under the Public Utility Regulatory Policies Act of 1978 (PURPA).

Pursuant to the provisions of FIN 46R, HECO is deemed to have a variable interest in Kalaeloa by reason of the provisions of HECO's PPA with Kalaeloa. However, management has concluded that HECO is not the primary beneficiary of Kalaeloa because HECO does not absorb the majority of Kalaeloa's expected losses nor receive a majority of Kalaeloa's expected residual returns and, thus, HECO has not consolidated Kalaeloa in its consolidated financial statements. A significant factor affecting the level of expected losses HECO would absorb is the fact that HECO's exposure to fuel price variability is limited to the remaining term of the PPA as compared to the facility's remaining useful life. Although HECO absorbs fuel price variability for the remaining term of the PPA, the PPA does not currently expose HECO to losses as the fuel and fuel related energy payments under the PPA have been approved by the PUC for recovery from customers through base electric rates and through HECO's ECAC to the extent the fuel and fuel-related energy payments are not included in base energy rates.

*Apollo Energy Corporation.* In October 2004, HELCO and Apollo Energy Corporation (Apollo) executed a restated and amended PPA which enables Apollo to repower its 7 MW facility, and install additional capacity, for a total allowed capacity of 20.5 MW. In December 2005, Apollo assigned the PPA to a subsidiary, which voluntarily, unilaterally and irrevocably waived and relinquished its right and benefit under the PPA to collect the floor rate for the entire term of the PPA. The 20.5 MW facility began commercial operations in April 2007. Based on information available, management concluded that HELCO does not have to consolidate Apollo as HELCO does not have a variable interest in Apollo because the PPA does not require HELCO to absorb any variability of Apollo.

**(3) Revenue taxes**

HECO and its subsidiaries' operating revenues include amounts for various revenue taxes. Revenue taxes are generally recorded as an expense in the period the related revenues are recognized. HECO and its subsidiaries' payments to the taxing authorities are based on the prior year's revenues. For the six months ended June 30, 2007 and 2006, HECO and its subsidiaries included approximately \$83 million and \$87 million, respectively, of revenue taxes in operating revenues and in taxes, other than income taxes expense.

**(4) Retirement benefits**

For the first six months of 2007, HECO and its subsidiaries contributed \$4.2 million to their retirement benefit plans, compared to \$5.1 million in the first six months of 2006. HECO and its subsidiaries' current estimate of contributions to their retirement benefit plans in 2007 is \$12.1 million, compared to contributions of \$9.8 million in 2006. In addition, HECO and its subsidiaries expect to pay directly \$0.5 million of benefits in 2007, compared to \$0.6 million paid in 2006.

The components of net periodic benefit cost were as follows:

	Three months ended June 30				Six months ended June 30			
	Pension benefits		Other benefits		Pension benefits		Other benefits	
	2007	2006	2007	2006	2007	2006	2007	2006
(in thousands)								
Service cost	\$ 6,360	\$ 6,819	\$ 1,179	\$ 1,247	\$ 12,691	\$ 13,359	\$ 2,379	\$ 2,482
Interest cost	12,864	12,135	2,696	2,510	25,686	24,174	5,483	5,169
Expected return on plan assets	(15,254)	(16,301)	(2,364)	(2,452)	(30,478)	(32,233)	(4,621)	(4,879)
Amortization of unrecognized transition obligation	1		783	783	1	1	1,565	1,565
Amortization of prior service gain	(191)	(192)			(381)	(385)		
Recognized actuarial loss (gain)	2,620	2,635		(19)	5,236	5,349		194

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Net periodic benefit cost	\$ 6,400	\$ 5,096	\$ 2,294	\$ 2,069	\$ 12,755	\$ 10,265	\$ 4,806	\$ 4,531
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HECO and its subsidiaries recorded retirement benefits expense of \$14 million and \$11 million in the first six months of 2007 and 2006, respectively. The electric utilities charged a portion of the net periodic benefit costs to plant. Also, in an interim order issued in April 2007 (discussed below), the amount of HELCO's net periodic benefit costs to be recovered in rates was established. Thus, any costs determined under SFAS No. 87, as amended, that are over/under this amount are charged/credited to a regulatory asset. Further, under the interim order, a regulatory asset (representing HELCO's prepaid pension asset as of December 31, 2006 prior to the adoption of SFAS No. 158) was allowed to be recovered (and is being amortized) over a period of five years.

In an April 4, 2007 interim Decision and Order (D&O) in HELCO's 2006 test year rate case, the PUC approved on an interim basis the adoption of a pension tracking mechanism proposed by the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii (Consumer Advocate). The mechanism is intended to smooth the impact to ratepayers of potential fluctuations in pension costs, and generally would require HELCO to make contributions to the pension trust in the amount of the actuarially calculated net periodic pension cost that would be allowed without penalty by the tax laws. A similar tracking mechanism for postretirement benefits other than pensions was also approved on an interim basis. As a result of these approvals, which are subject to the PUC's final D&O, HELCO reclassified, beginning April 5, 2007, to a regulatory asset the charge for retirement benefits that would otherwise be recorded in accumulated other comprehensive income (pursuant to SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans). Retirement benefits expense for HELCO for the second quarter of 2007 was \$1.3 million, but would have been \$0.9 million if the pension and OPEB tracking mechanisms had not been adopted.

**(5) Commitments and contingencies****Interim increases**

On September 27, 2005, the PUC issued an Interim D&O in HELCO's 2005 test year rate case granting a general rate increase on Oahu of 4.36%, or \$53.3 million (3.33%, or \$41.1 million excluding the transfer of certain costs from a surcharge line item on electric bills into base electricity charges), which was implemented on September 28, 2005.

On April 4, 2007, the PUC issued an interim D&O in HELCO's 2006 test year rate case granting a general rate increase on the island of Hawaii of 7.58%, or \$24.6 million, which was implemented on April 5, 2007.

As of June 30, 2007, HECO and its subsidiaries had recognized \$110 million of revenues with respect to interim orders (\$14 million related to interim orders regarding certain integrated resource planning costs and \$96 million related to interim orders with respect to HELCO's and HELCO's general rate increase requests based on a 2005 and 2006 test year, respectively, and HECO's interim surcharge to recover DG fuel and fuel trucking costs), which revenues are subject to refund, with interest, if and to the extent they exceed the amounts allowed in final orders.

**Energy cost adjustment clauses**

On June 19, 2006, the PUC issued an order in HELCO's pending rate case based on a 2005 test year, indicating that the record in the pending case has not been developed for the purpose of addressing the factors in Act 162, signed into law by the Governor of Hawaii on June 2, 2006. Act 162 states that any automatic fuel rate adjustment clause requested by a public utility in an application filed with the PUC shall be designed, as determined in the PUC's discretion, to (1) fairly share the risk of fuel cost changes between the public utility and its customers, (2) provide the public utility with sufficient incentive to reasonably manage or lower its fuel costs and encourage greater use of renewable energy, (3) allow the public utility to mitigate the risk of sudden or frequent fuel cost changes that cannot otherwise reasonably be mitigated through other commercially available means, such as through fuel hedging contracts, (4) preserve, to the extent reasonably possible, the public utility's financial integrity, and (5) minimize, to the extent reasonably possible, the public utility's need to apply for frequent applications for general rate increases to account for the changes to its fuel costs. While the PUC already reviewed the automatic fuel rate adjustment clause in rate cases, Act 162 required that these five specific factors be addressed in the record. The PUC's order requested the parties in the rate case proceeding to meet informally to determine a procedural schedule to address the issues relating to HELCO's ECAC that are raised by Act 162. The parties in the rate case proceeding are HECO, the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii (Consumer Advocate), and the federal Department of Defense (DOD).

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On June 30, 2006, HECO and the Consumer Advocate filed a stipulation requesting that the PUC not review the Act 162 ECAC issues in the pending rate case based on a 2005 test year since HECO's application was filed and the record in the proceeding was completed before Act 162 was signed into law, and the settlement agreement entered into by the parties in the rate case (subject to PUC approval) included a provision allowing the existing ECAC to be continued. On August 7, 2006, an amended stipulation was filed in substantially the same form as the June 30, 2006 stipulation, but also included the DOD. Management cannot predict whether the PUC will accept the disposition of the Act 162 issue proposed in the amended stipulation or, if not, the procedural steps or procedural schedule that will be adopted to address the issues that are raised by Act 162 or the timing of the PUC's issuance of a final D&O in HECO's pending 2005 test year rate case.

The ECAC provisions of Act 162 were reviewed in the HELCO rate case based on a 2006 test year and will be reviewed in the HECO and MECO rate cases based on 2007 test years. In the HELCO 2006 test year rate case, the filed testimony of the Consumer Advocate's consultant concluded that HELCO's ECAC provides a fair sharing of the risks of fuel cost changes between HELCO and its ratepayers in a manner that preserves the financial integrity of HELCO without the need for frequent rate filings. On April 4, 2007 the PUC issued an interim D&O in the HELCO 2006 test year rate case which reflected the continuation of HELCO's ECAC, consistent with a settlement agreement reached between HELCO and the Consumer Advocate.

Management cannot predict the ultimate effect of the required Act 162 analysis on the continuation of the electric utilities' existing ECACs.

On April 23, 2007, the PUC issued an order denying HECO's proposal to recover DG fuel and trucking and low sulfur fuel oil (LFSO) trucking costs since January 1, 2006 through the reconciliation process for the ECAC. However, the PUC allowed HECO to establish and implement a new and separate interim surcharge to recover its additional DG and LFSO costs on a going forward basis. HECO implemented an interim surcharge to recover such costs incurred from May 1, 2007.

### **HELCO power situation**

In 1991, HELCO began planning to meet increased electric generation demand forecast for 1994. It planned to install at its Keahole power plant two 20 MW combustion turbines (CT-4 and CT-5), followed by an 18 MW heat recovery steam generator (ST-7), at which time these units would be converted to a 56 MW (net) dual-train combined-cycle unit. In January 1994, the PUC approved expenditures for CT-4. In 1995, the PUC allowed HELCO to pursue construction of and commit expenditures for CT-5 and ST-7, but noted that such costs are not to be included in rate base until the project is installed and is used and useful for utility purposes. As a result of the final resolution of various proceedings, CT-4 and CT-5 became operational in mid-2004, there are no pending lawsuits involving the project, and work on ST-7 is proceeding. Noise mitigation equipment has been installed on CT-4 and CT-5 and additional noise mitigation work is ongoing to ensure compliance with the night-time noise standard applicable to the plant. Currently, HELCO can operate the generating units at Keahole as required to meet its system needs. Construction of a noise barrier is scheduled for completion by the end of 2007, which should allow the units to operate full time.

Settlement Agreement: ST-7 costs incurred. In 2003, the parties opposing the plant expansion project (other than Waimana Enterprises, Inc. (Waimana), which did not participate in the settlement discussions and opposed the settlement) entered into a settlement agreement with HELCO and several Hawaii regulatory agencies, intended in part to permit HELCO to complete CT-4 and CT-5 (Settlement Agreement). The Settlement Agreement required HELCO to undertake a number of actions including expediting efforts to obtain the permits and approvals necessary for installation of ST-7 with selective catalytic reduction emissions control equipment, assisting the Department of Hawaiian Home Lands in installing solar water heating in its housing projects, supporting the Keahole Defense Coalition's participation in certain PUC cases, and cooperating with neighbors and community groups (including a Hot Line service). Other than required payments to other parties to the settlement agreement, which were timely made, many of these actions are ongoing.

HELCO's plans for ST-7 are progressing. In November 2003, HELCO filed a boundary amendment petition (to reclassify the Keahole plant site from conservation land use to urban land use) with the State of Hawaii Land Use Commission, which boundary amendment was approved in October 2005. In May 2006, HELCO obtained the County

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of Hawaii rezoning to a General Industrial classification, and in June 2006, received approval for a covered source permit amendment to include selective catalytic reduction with the installation of ST-7. Management believes that any other required permits will be obtained and anticipates an in-service date for ST-7 in late 2009. HELCO has commenced engineering, design and certain construction work for ST-7. HELCO's current cost estimate for ST-7 is approximately \$92 million, of which approximately \$3.7 million has been incurred through June 30, 2007.

*CT-4 and CT-5 costs incurred.* HELCO's capitalized costs incurred in its efforts to put CT-4 and CT-5 into service and to support existing units (excluding costs for pre-air permit facilities) amounted to approximately \$110 million. The \$110 million of costs was reclassified from construction in progress to plant and equipment in 2004 (\$103 million) and 2005 (\$7 million) and depreciated beginning January 1, 2005 and 2006, respectively, and HELCO sought recovery of these costs as part of its 2006 test year rate case.

In March 2007, HELCO and the Consumer Advocate reached a settlement of the issues in the HELCO 2006 rate case proceeding, subject to PUC approval. Under the settlement, HELCO agreed to write-off approximately \$12 million of plant-in-service costs, net of average accumulated depreciation, relating to CT-4 and CT-5, resulting in an after-tax charge to net income in the first quarter of 2007 of approximately \$7 million (included in Other, net under Other income (loss) on HELCO's consolidated statement of income).

In April 2007, the PUC issued an interim D&O granting HELCO a 7.58% increase in rates, which reflects the settlement agreement reached between HELCO and the Consumer Advocate, including the agreement to write-off a portion of CT-4 and CT-5 costs. However, the interim order does not commit the PUC to accept any of the amounts in the interim increase in its final order. If it becomes probable that the PUC, in its final order, will disallow additional costs incurred for CT-4 and CT-5 for rate-making purposes, HELCO will be required to record an additional write-off.

**East Oahu Transmission Project (EOTP)**

HECO transmits bulk power to the Honolulu/East Oahu area over two major transmission corridors (Northern and Southern). HECO had planned to construct a partial underground/partial overhead 138 kilovolt (kV) line from the Kamoku substation to the Pukele substation, which serves approximately 16% of Oahu's electrical load, including Waikiki, in order to close the gap between the Southern and Northern corridors and provide a third transmission line to the Pukele substation. However, in June 2002, an application for a permit which would have allowed construction in the originally planned route through conservation district lands was denied.

HECO continued to believe that the proposed reliability project (the East Oahu Transmission Project) was needed and, in December 2003, filed an application with the PUC requesting approval to commit funds (currently estimated at \$64 million; see costs incurred below) for a revised EOTP using a 46 kV system. In March 2004, the PUC granted intervenor status to an environmental organization and three elected officials (collectively treated as one party), and a more limited participant status to four community organizations. The environmental review process for the revised EOTP was completed and the PUC issued a Finding of No Significant Impact in April 2005.

In written testimony filed in June 2005, the consultant for the Consumer Advocate contended that HECO should always have planned for a project using only the 46 kV system and recommended that HECO be required to expense the \$12 million incurred prior to the denial in 2002 of the approval necessary for the partial underground/partial overhead 138 kV line, and the related allowance for funds used during construction (AFUDC) of \$5 million. In rebuttal testimony filed in August 2005, HECO contested the consultant's recommendation, emphasizing that the originally proposed 138 kV line would have been a more comprehensive and robust solution to the transmission concerns the project addressed. The PUC held an evidentiary hearing on HECO's application in November 2005, and post-hearing briefing was completed in March 2006. Just prior to the November 2005 evidentiary hearing, the PUC approved that part of a stipulation between HECO and the Consumer Advocate providing that (i) this proceeding should determine whether HECO should be given approval to expend funds for the EOTP, but with the understanding that no part of the EOTP costs may be recovered from ratepayers unless and until the PUC grants HECO recovery in a rate case (which is consistent with other projects) and (ii) the issue as to whether the pre-2003 planning and permitting costs, and related AFUDC, should be included in the project costs is reserved to, and may be raised in, the next HECO rate case (or other proceeding) in which HECO seeks approval to recover the EOTP costs.

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Subject to obtaining PUC approval and other construction permits, HECO plans to construct the revised project, none of which is in conservation district lands, in two phases. The first phase is currently projected to be completed in 2009, subject to the timing of PUC approval, and the completion date of the second phase is being evaluated.

As of June 30, 2007, the accumulated costs recorded for the EOTP amounted to \$31 million, including (i) \$12 million of planning and permitting costs incurred prior to 2003, (ii) \$5 million of planning and permitting costs incurred after 2002 and (iii) \$14 million for AFUDC. Management believes no adjustment to project costs is required as of June 30, 2007. However, if it becomes probable that the PUC will disallow some or all of the incurred costs for rate-making purposes, HECO may be required to write off a material portion or all of the project costs incurred in its efforts to put the project into service whether or not it is completed.

### **Environmental regulation**

HEI and its subsidiaries are subject to environmental laws and regulations that regulate the operation of existing facilities, the construction and operation of new facilities and the proper cleanup and disposal of hazardous waste and toxic substances.

HECO, HELCO and MECO, like other utilities, periodically identify petroleum or other chemical releases into the environment associated with current operations and report and take action on these releases when and as required by applicable law and regulations. Except as otherwise disclosed herein, the Company believes the costs of responding to its subsidiaries' releases identified to date will not have a material adverse effect, individually or in the aggregate, on the Company's or consolidated HECO's financial statements.

Additionally, current environmental laws may require HEI and its subsidiaries to investigate whether releases from historical operations may have contributed to environmental impacts, and, where appropriate, respond to such releases, even if they were not inconsistent with law or standard industrial practices prevailing at the time when they occurred. Such releases may involve area-wide impacts contributed to by multiple potentially responsible parties.

*Honolulu Harbor investigation.* In 1995, the Department of Health of the State of Hawaii (DOH) issued letters indicating that it had identified a number of parties, including HECO, who appeared to be potentially responsible for historical subsurface petroleum contamination and/or operated their facilities upon petroleum-contaminated land at or near Honolulu Harbor in the Iwilei district of Honolulu. Certain of the identified parties formed a work group to determine the nature and extent of any contamination and appropriate response actions, as well as to identify additional potentially responsible parties (PRPs). The U.S. Environmental Protection Agency (EPA) became involved in the investigation in June 2000. Later in 2000, the DOH issued notices to additional PRPs. The parties in the work group and some of the new PRPs (collectively, the Participating Parties) entered into a joint defense agreement and signed a voluntary response agreement with the DOH. The Participating Parties agreed to fund investigative and remediation work using an interim cost allocation method (subject to a final allocation) and have organized a limited liability company to perform the work.

In 2001, management developed a preliminary estimate of HECO's share of costs for continuing investigative work, remedial activities and monitoring at the Iwilei Unit of approximately \$1.1 million (which was expensed in 2001). Since 2001, subsurface investigation and assessment have been conducted and several preliminary oil removal tasks have been performed at the Iwilei Unit in accordance with notices of interest issued by the EPA and the DOH.

In 2003, HECO and other Participating Parties with active operations in the Iwilei area investigated their operations to evaluate whether their facilities were active sources of petroleum contamination in the area. HECO's investigation concluded that its facilities were not then releasing petroleum. Routine maintenance and inspections of HECO facilities since then confirm that they are not currently releasing petroleum.

During 2006 and the beginning of 2007, the PRPs developed analyses of various remedial alternatives for two of the four remedial subunits of the Iwilei Unit. The DOH will use the analyses to make a final determination of which remedial alternatives the PRPs will be required to implement. The DOH is scheduled to complete the final remediation determinations for all remedial subunits of the Iwilei Unit by the end of 2007 or first quarter of 2008. HECO management developed an estimate of HECO's share of the costs associated with implementing the PRP recommended remedial approaches for the two subunits covered by the analyses of approximately \$1.2 million, (which was expensed in 2006).

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As of June 30, 2007, the accrual (amounts expensed less amounts expended) related to the Honolulu Harbor investigation was \$1.4 million. Because (1) the full scope of additional investigative work, remedial activities and monitoring remain to be determined, (2) the final cost allocation method among the PRPs has not yet been established and (3) management cannot estimate the costs to be incurred (if any) for the sites other than the Iwilei Unit (such as its Honolulu power plant, which is located in the Downtown unit of the Honolulu Harbor site), the cost estimate may be subject to significant change and additional material investigative and remedial costs may be incurred.

**Regional Haze Rule amendments.** In June 2005, the EPA finalized amendments to the July 1999 Regional Haze Rule that require emission controls known as best available retrofit technology (BART) for industrial facilities emitting air pollutants that reduce visibility in National Parks by causing or contributing to regional haze. States must develop BART implementation plans and schedules in accordance with the amended regional haze rule by December 2007. After Hawaii adopts its plan, HECO, HELCO and MECO will evaluate the plan's impacts, if any, on them. If any of the utilities' generating units are ultimately required to install post-combustion control technologies to meet BART emission limits, the resulting capital and operation and maintenance costs could be significant.

**Clean Water Act.** Section 316(b) of the federal Clean Water Act requires that the EPA ensure that existing power plant cooling water intake structures reflect the best technology available for minimizing adverse environmental impacts. Effective September 9, 2004, the EPA issued a rule, which established location and technology-based design, construction and capacity standards for existing cooling water intake structures. These standards applied to HECO's Kahe, Waiau and Honolulu generating stations, unless the utility could demonstrate that at each facility implementation of these standards would result in costs either significantly higher than projected costs the EPA considered in establishing the standards for the facility (cost-cost test) or significantly greater than the benefits of meeting the standards (cost-benefit test). In either case, the EPA would then make a case-by-case determination of an appropriate performance standard. The regulation also would have allowed restoration of aquatic organism populations in lieu of meeting the standards. The rule required covered facilities to demonstrate compliance by March 2008. HECO had retained a consultant that was developing a cost effective compliance strategy and a preliminary assessment of technologies and operational measures under the rule.

On January 25, 2007, the U.S. Circuit Court for the Second Circuit issued a decision in *Riverkeeper, Inc. v. EPA* that remanded for further consideration and proceedings significant portions of the rule and found other portions of the rule to be impermissible. In particular, the court determined that restoration and the cost-benefit test were impermissible under the Clean Water Act. It also remanded the best technology available determination to permit the EPA to provide a reasoned explanation for its decision or a new determination. It remanded the cost-cost test for the EPA's further consideration based on the best technology available determination and to afford adequate notice. The EPA is considering an appeal of the decision to the U.S. Supreme Court. If the decision stands, the Court of Appeals ruling reduces the compliance options available to HECO. In addition, the EPA has not issued a schedule for rulemaking, which would be necessary to comply with the court's decision. On March 20, 2007, the EPA announced it had suspended the rule pending appeal or additional rulemaking. On July 9, 2007, the EPA formalized its determination to suspend the rule in a Federal Register notice. In the announcement, the EPA provided guidance to federal and state permit writers that they should use their best professional judgment in determining permit conditions regarding cooling water intake requirements at existing power plants. Currently, this guidance does not affect the HECO facilities subject to the cooling water intake requirements because none of the facilities are subject to permit renewal until mid-2009. Due to the uncertainties raised by the court's decision as well as the need for further rulemaking by the EPA, management is unable to predict which compliance options, some of which could entail significant capital expenditures to implement, will be applicable to its facilities.

## **Collective bargaining agreements**

As of June 30, 2007, approximately 58% of the electric utilities' employees are members of the International Brotherhood of Electrical Workers, AFL-CIO, Local 1260, Unit 8, which is the only union representing employees of the Company. The current collective bargaining and benefit agreements cover a four-year term, from November 1, 2003 to October 31, 2007, and provided for non-compounded wage increases (3% on November 1, 2003; 1.5% on



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November 1, 2004, May 1, 2005, November 1, 2005 and May 1, 2006; and 3% on November 1, 2006). Negotiations for new agreements are expected to begin in the third quarter of 2007.

**(6) Cash flows**

**Supplemental disclosures of cash flow information**

For the six months ended June 30, 2007 and 2006, HECO and its subsidiaries paid interest amounting to \$23.5 million and \$22.7 million, respectively.

For the six months ended June 30, 2007 and 2006, HECO and its subsidiaries paid income taxes amounting to \$5.2 million and \$5.5 million, respectively.

**Supplemental disclosure of noncash activities**

The allowance for equity funds used during construction, which was charged to construction in progress as part of the cost of electric utility plant, amounted to \$2.4 million and \$3.1 million for the six months ended June 30, 2007 and 2006, respectively.

**(7) Recent accounting pronouncements and interpretations**

For a discussion of recent accounting pronouncements and interpretations, see Note 9 of HEI's Notes to Consolidated Financial Statements.

**(8) Income taxes**

The electric utilities record interest and penalties on income taxes in Interest and other charges. Interest accrued on income taxes was insignificant in the first six months of 2006 and \$0.2 million in the first six months of 2007.

As of January 1, 2007, the total amount of accrued interest and penalties related to uncertain tax positions and recognized on the balance sheet was \$0.6 million.

As of January 1, 2007, the total amount of unrecognized tax benefits was \$4.7 million, and of this amount, \$0.2 million, if recognized, would affect the electric utilities' effective tax rate. Management concluded that it is reasonably possible that the unrecognized tax benefits will significantly decrease within the next 12 months due to the resolution of issues under examination by the Internal Revenue Service. Management cannot estimate the range of the reasonably possible change.

Tax years 2003 to 2006 currently remain subject to examination by the Internal Revenue Service and Department of Taxation of the State of Hawaii.

The electric utilities had an effective tax rate for the first six months of 2007 of 35%, compared to 38% for the first six months of 2006), primarily due to the low pre-tax income and the impact of state tax credits (including the acceleration of the state tax credits associated with the write off of a portion of CT-4 and CT-5 costs) recognized against a smaller income tax expense base.

**(9) Reconciliation of electric utility operating income per HEI and HECO consolidated statements of income**

Three months ended	Six months ended
June 30	June 30

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	2007	2006	2007	2006
<b>(in thousands)</b>				
Operating income from regulated and nonregulated activities before income taxes (per HEI consolidated statements of income)	\$ 28,789	\$ 39,846	\$ 41,781	\$ 85,426
Deduct:				
Income taxes on regulated activities	(6,492)	(11,020)	(10,998)	(24,244)
Revenues from nonregulated activities	(1,463)	(617)	(2,344)	(1,702)
Add: Expenses from nonregulated activities	388	293	12,286	584
Operating income from regulated activities after income taxes (per HECO consolidated statements of income)	\$ 21,222	\$ 28,502	\$ 40,725	\$ 60,064

**(10) Credit agreement**

Effective April 3, 2006, HECO entered into a revolving unsecured credit agreement establishing a line of credit facility of \$175 million with a syndicate of eight financial institutions. On March 14, 2007 the PUC issued a D&O approving HECO's request to maintain the credit facility for five years (until March 31, 2011), to borrow under the credit facility with maturities in excess of 364 days, to use the proceeds from any borrowings with

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maturities in excess of 364 days to finance capital expenditures and/or to repay short-term or other borrowings used to finance or refinance capital expenditures and to use an expedited approval process to obtain PUC approval to increase the facility amount, renew the facility, refinance the facility or change other terms of the facility if such changes are required or desirable.

Any draws on the facility bear interest, at the option of HECO, at either the Adjusted LIBO Rate plus 40 basis points or the greater of (a) the Prime Rate and (b) the sum of the Federal Funds Rate plus 50 basis points, as defined in the agreement. The annual fee is 8 basis points on the undrawn commitment amount. The agreement contains provisions for revised pricing in the event of a ratings change. For example, a ratings downgrade of HECO's Senior Debt Rating (e.g., from BBB+/Baa1 to BBB/Baa2 by S&P and Moody's, respectively) would result in a commitment fee increase of 2 basis points and an interest rate increase of 10 basis points on any drawn amounts. On the other hand, a ratings upgrade (e.g., from BBB+/Baa1 to A-/A3) would result in a commitment fee decrease of 1 basis point and an interest rate decrease of 10 basis points on any drawn amounts. The agreement does not contain clauses that would affect access to the lines by reason of a ratings downgrade, nor does it have a broad material adverse change clause. However, the agreement does contain customary conditions that must be met in order to draw on it, such as the accuracy of certain of its representations at the time of a draw and compliance with its covenants (such as covenants preventing its subsidiaries from entering into agreements that restrict the ability of the subsidiaries to pay dividends to, or to repay borrowings from, HECO, and restricting HECO's ability, as well as the ability of any of its subsidiaries, to guarantee indebtedness of the subsidiaries if such additional debt would cause the subsidiary's Consolidated Subsidiary Funded Debt to Capitalization Ratio to exceed 65% (ratios of 48% for HELCO and 43% for MECO as of June 30, 2007, as calculated under the agreement)). In addition to customary defaults, HECO's failure to maintain its financial ratios, as defined in its agreement, or meet other requirements will result in an event of default. For example, under the agreement, it is an event of default if HECO fails to maintain a Consolidated Capitalization Ratio (equity) of at least 35% (ratio of 54% as of June 30, 2007, as calculated under the agreement), if HECO fails to remain a wholly-owned subsidiary of HEI or if any event or condition occurs that results in any Material Indebtedness of HECO or any of its significant subsidiaries being subject to acceleration prior to its scheduled maturity. HECO's syndicated credit facility is maintained to support the issuance of commercial paper, but it may also be drawn for general corporate purposes and capital expenditures. As of August 1, 2007, the \$175 million credit facility remained undrawn.

On May 23, 2007, S&P lowered the long-term corporate credit and unsecured debt ratings on HECO, HELCO and MECO to BBB from BBB+ and stated that the downgrade is the result of sustained weak bondholder protection parameters compounded by the financial pressure that continuous need for regulatory relief, driven by heightened capital expenditure requirements, is creating for the next few years. The pricing for future borrowings under the line of credit facility did not change since the pricing level is "determined by the higher of the two" ratings by S&P and Moody's, and Moody's ratings did not change.

**(11) Special Purpose Revenue Bonds (SPRBs)**

On March 27, 2007, the Department of Budget and Finance of the State of Hawaii (the Department) issued (pursuant to a 2005 legislative authorization), at par, Series 2007A SPRBs in the aggregate principal amount of \$140 million, with a maturity of March 1, 2037 and a fixed coupon interest rate of 4.65%, and loaned the proceeds to HECO (\$100 million), HELCO (\$20 million) and MECO (\$20 million). Payment of the principal and interest on the SPRBs are insured by a surety bond issued by Financial Guaranty Insurance Company. Proceeds will be used to finance capital expenditures, including reimbursements to the electric utilities for previously incurred capital expenditures which, in turn, will be used primarily to repay short-term borrowings. As of June 30, 2007, approximately \$44 million of proceeds from the Series 2007A SPRBs had not yet been drawn and were held by the construction fund trustee. HECO, HELCO and MECO's long-term debt will increase from time to time as these remaining proceeds are drawn down.

On March 27, 2007, the Department issued, at par, Refunding Series 2007B SPRBs in the aggregate principal amount of \$125 million, with a maturity of May 1, 2026 and a fixed coupon interest rate of 4.60%, and loaned the proceeds to HECO (\$62 million), HELCO (\$8 million) and MECO (\$55 million). Proceeds from the sale were applied, together with other funds provided by the electric utilities, to the redemption at par on May 1, 2007 of the \$75 million

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aggregate principal amount of 6.20% Series 1996A SPRBs (which had an original maturity of May 1, 2026) and to the redemption at a 2% premium on April 27, 2007 of the \$50 million aggregate principal amount of 5 7/8% Series 1996B SPRBs (which had an original maturity of December 1, 2026). Payment of the principal and interest on the refunding SPRBs are insured by a surety bond issued by Financial Guaranty Insurance Company.

**(12) Consolidating financial information**

HECO is not required to provide separate financial statements or other disclosures concerning HELCO and MECO to holders of the 2004 Debentures issued by HELCO and MECO to Trust III since all of their voting capital stock is owned, and their obligations with respect to these securities have been fully and unconditionally guaranteed, on a subordinated basis, by HECO. Consolidating information is provided below for these and other HECO subsidiaries for the periods ended and as of the dates indicated.

HECO also unconditionally guarantees HELCO's and MECO's obligations (a) to the State of Hawaii for the repayment of principal and interest on Special Purpose Revenue Bonds issued for the benefit of HELCO and MECO and (b) relating to the trust preferred securities of Trust III. Also, see Note 2. HECO is also obligated, after the satisfaction of its obligations on its own preferred stock, to make dividend, redemption and liquidation payments on HELCO's and MECO's preferred stock if the respective subsidiary is unable to make such payments.

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (unaudited)**

Three months ended June 30, 2007

(in thousands)	HECO	HELCO	MECO	RHI	Reclassifications and eliminations	HECO consolidated
<b>Operating revenues</b>	\$ 319,652	86,644	84,953			\$ 491,249
<b>Operating expenses</b>						
Fuel oil	109,775	15,667	41,679			167,121
Purchased power	92,419	33,420	7,888			133,727
Other operation	36,845	8,156	8,642			53,643
Maintenance	17,639	5,405	6,825			29,869
Depreciation	19,745	7,523	7,004			34,272
Taxes, other than income taxes	29,264	7,944	7,695			44,903
Income taxes	3,085	2,326	1,081			6,492
	308,772	80,441	80,814			470,027
<b>Operating income</b>	10,880	6,203	4,139			21,222
<b>Other income</b>						
Allowance for equity funds used during construction	1,044	68	90			1,202
Equity in earnings of subsidiaries	5,764				(5,764)	
Other, net	1,250	171	251	(14)	(609)	1,049
	8,058	239	341	(14)	(6,373)	2,251
<b>Income (loss) before interest and other charges</b>	18,938	6,442	4,480	(14)	(6,373)	23,473
<b>Interest and other charges</b>						
Interest on long-term debt	7,324	1,915	2,151			11,390
Amortization of net bond premium and expense	400	106	140			646
Other interest charges	802	608	73		(609)	874
Allowance for borrowed funds used during construction	(508)	(34)	(44)			(586)
Preferred stock dividends of subsidiaries					229	229
	8,018	2,595	2,320		(380)	12,553
<b>Income (loss) before preferred stock dividends of HECO</b>	10,920	3,847	2,160	(14)	(5,993)	10,920
Preferred stock dividends of HECO	270	133	96		(229)	270
<b>Net income (loss) for common stock</b>	\$ 10,650	3,714	2,064	(14)	(5,764)	\$ 10,650



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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (unaudited)**

Three months ended June 30, 2006

(in thousands)	HECO	HELCO	MECO	RHI	Reclassifications and eliminations	HECO consolidated
<b>Operating revenues</b>	\$ 339,213	80,736	83,401			\$ 503,350
<b>Operating expenses</b>						
Fuel oil	130,757	18,035	43,522			192,314
Purchased power	86,527	30,118	5,793			122,438
Other operation	32,209	7,760	7,965			47,934
Maintenance	14,829	4,077	3,476			22,382
Depreciation	18,702	7,431	6,409			32,542
Taxes, other than income taxes	31,076	7,540	7,602			46,218
Income taxes	6,928	1,233	2,859			11,020
	321,028	76,194	77,626			474,848
<b>Operating income</b>	18,185	4,542	5,775			28,502
<b>Other income</b>						
Allowance for equity funds used during construction	916	53	619			1,588
Equity in earnings of subsidiaries	6,376				(6,376)	
Other, net	918	58	284	(55)	(684)	521
	8,210	111	903	(55)	(7,060)	2,109
<b>Income (loss) before interest and other charges</b>	26,395	4,653	6,678	(55)	(7,060)	30,611
<b>Interest and other charges</b>						
Interest on long-term debt	6,741	1,808	2,227			10,776
Amortization of net bond premium and expense	339	101	103			543
Other interest charges	2,168	650	92		(684)	2,226
Allowance for borrowed funds used during construction	(409)	(23)	(287)			(719)
Preferred stock dividends of subsidiaries					229	229
	8,839	2,536	2,135		(455)	13,055
<b>Income (loss) before preferred stock dividends of HECO</b>	17,556	2,117	4,543	(55)	(6,605)	17,556
Preferred stock dividends of HECO	270	133	96		(229)	270
<b>Net income (loss) for common stock</b>	\$ 17,286	1,984	4,447	(55)	(6,376)	\$ 17,286





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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (unaudited)**

Six months ended June 30, 2007

(in thousands)	HECO	HELCO	MECO	RHI	Reclassifications and eliminations	HECO consolidated
<b>Operating revenues</b>	\$ 608,342	165,453	164,251			\$ 938,046
<b>Operating expenses</b>						
Fuel oil	210,837	35,705	80,508			327,050
Purchased power	170,719	60,482	14,042			245,243
Other operation	70,330	15,322	15,184			100,836
Maintenance	34,017	10,973	12,215			57,205
Depreciation	39,484	15,047	14,008			68,539
Taxes, other than income taxes	56,966	15,307	15,177			87,450
Income taxes	5,055	2,864	3,079			10,998
	587,408	155,700	154,213			897,321
<b>Operating income</b>	20,934	9,753	10,038			40,725
<b>Other income</b>						
Allowance for equity funds used during construction	2,131	133	170			2,434
Equity in earnings of subsidiaries	2,827				(2,827)	
Other, net	2,735	(6,692)	257	(29)	(1,420)	(5,149)
	7,693	(6,559)	427	(29)	(4,247)	(2,715)
<b>Income (loss) before interest and other charges</b>	28,627	3,194	10,465	(29)	(4,247)	38,010
<b>Interest and other charges</b>						
Interest on long-term debt	14,449	3,772	4,665			22,886
Amortization of net bond premium and expense	748	205	239			1,192
Other interest charges	2,824	1,365	246		(1,420)	3,015
Allowance for borrowed funds used during construction	(1,037)	(65)	(82)			(1,184)
Preferred stock dividends of subsidiaries					458	458
	16,984	5,277	5,068		(962)	26,367
<b>Income (loss) before preferred stock dividends of HECO</b>	11,643	(2,083)	5,397			