HAWAIIAN ELECTRIC INDUSTRIES INC
Form 10-Q
August 01, 2006
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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, 2006

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.	**1-8503**	**99-0208097**
and Principal Subsidiary		
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)

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 x 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 x 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 x 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 x

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 x

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 x

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 27, 2006
Hawaiian Electric Industries, Inc. (Without Par Value)	81,284,371 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

Form 10-Q Quarter ended June 30, 2006

GLOSSARY OF TERMS

Terms	Definitions
AFUDC	Allowance for funds used during construction
AOCI	Accumulated other comprehensive income
ASB	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.) and AdCommunications, Inc. Former subsidiaries include ASB Realty Corporation (dissolved in May 2005).
BLNR	Board of Land and Natural Resources of the State of Hawaii
CHP	Combined heat and power
Company	Hawaiian Electric Industries, Inc. and its direct and indirect subsidiaries, including, without limitation, Hawaiian Electric Company, Inc., Maui Electric Company, Limited, Hawaii Electric Light Company, Inc., HECO Capital Trust III*, Renewable Hawaii, Inc., HEI Diversified, Inc., American Savings Bank, F.S.B. and its subsidiaries, Pacific Energy Conservation Services, Inc., HEI Properties, Inc., Hycap Management, Inc. (in dissolution), Hawaiian Electric Industries Capital Trust II*, Hawaiian Electric Industries Capital Trust III*, The Old Oahu Tug Service, Inc. and HEI Power Corp. and its subsidiaries (discontinued operations, except for subsidiary HEI Investments, Inc.). (*unconsolidated subsidiaries)
Consumer Advocate	Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii
D&O	Decision and order
DG	Distributed generation
DOD	Department of Defense federal
DOH	Department of Health of the State of Hawaii
DRIP	HEI Dividend Reinvestment and Stock Purchase Plan
DSM	Demand-side management
EPA	Environmental Protection Agency federal
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
Federal	U.S. Government
FHLB	Federal Home Loan Bank
FIN	Financial Accounting Standards Board Interpretation
GAAP	Accounting principles generally accepted in the United States of America
HECO	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.

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GLOSSARY OF TERMS, continued

Terms	Definitions
HEI	Hawaiian Electric Industries, Inc., direct parent company of Hawaiian Electric Company, Inc., HEI Diversified, Inc., Pacific Energy Conservation Services, Inc., HEI Properties, Inc., Hycap Management, Inc. (in dissolution), Hawaiian Electric Industries Capital Trust II*, Hawaiian Electric Industries Capital Trust III*, The Old Oahu Tug Service, Inc. and HEI Power Corp. (discontinued operations, except for subsidiary HEI Investments, Inc.). (*unconsolidated subsidiaries)
HEIDI	HEI Diversified, Inc., a wholly owned subsidiary of Hawaiian Electric Industries, Inc. and the parent company of American Savings Bank, F.S.B.
HEIII	HEI Investments, Inc. (formerly HEI Investment Corp.), a subsidiary of HEI Power Corp.
HEIPC	HEI Power Corp., a wholly owned subsidiary of Hawaiian Electric Industries, Inc., and the 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 Group	HEI Power Corp. and its subsidiaries
HEIRSP	Hawaiian Electric Industries Retirement Savings Plan
HELCO	Hawaii Electric Light Company, Inc., an electric utility subsidiary of Hawaiian Electric Company, Inc.
HPower	City and County of Honolulu with respect to a power purchase agreement for a refuse-fired plant
IPP	Independent power producer
IRP	Integrated resource plan
KWH	Kilowatthour
MECO	Maui Electric Company, Limited, an electric utility subsidiary of Hawaiian Electric Company, Inc.
MW	Megawatt/s (as applicable)
NII	Net interest income
NPV	Net portfolio value
PPA	Power purchase agreement
PRPs	Potentially responsible parties
PUC	Public Utilities Commission of the State of Hawaii
RHI	Renewable Hawaii, Inc., a wholly owned subsidiary of Hawaiian Electric Company, Inc.
ROACE	Return on average common equity
ROR	Return on average rate base
SEC	Securities and Exchange Commission
See	Means the referenced material is incorporated by reference
SFAS	Statement of Financial Accounting Standards
SOIP	1987 Stock Option and Incentive Plan, as amended
SOX	Sarbanes-Oxley Act of 2002
SPRBs	Special Purpose Revenue Bonds
TOOTS	The Old Oahu Tug Service, a wholly owned subsidiary of Hawaiian Electric Industries, Inc.
VIE	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. I 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;

- 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, relations with Iran, 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, including those resulting from final adoption of proposed pension reform legislation;

- 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 reserve margins on Oahu are lower than considered desirable;

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;

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 and their subsidiaries (including changes in taxation, environmental laws and regulations and governmental fees and assessments); decisions by the Public Utilities Commission of the State of Hawaii (PUC) in rate cases 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 with respect to environmental conditions, capital adequacy and business practices);

increasing operations and maintenance expenses for the electric utilities and the possibility of more frequent rate cases;

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

the effects of changes in accounting principles applicable to HEI, HECO and their subsidiaries, including the adoption of new accounting principles (such as the effects of proposed changes in the accounting for retirement benefits, if and when effective), continued regulatory accounting under Statement of Financial Accounting Standards (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 power purchase arrangements 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 mix which may have an adverse impact on ASB s cost of funds;

the final outcome of tax positions taken by HEI, HECO 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 and its subsidiaries undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Hawaiian Electric Industries, Inc. and Subsidiaries

Consolidated Balance Sheets (unaudited)

(dollars in thousands)	June 30, 2006	December 31, 2005
Assets		
Cash and equivalents	$ 144,945	$ 151,513
Federal funds sold	81,121	57,434
Accounts receivable and unbilled revenues, net	247,817	249,473
Available-for-sale investment and mortgage-related securities	2,506,444	2,629,351
Investment in stock of Federal Home Loan Bank of Seattle, at cost	97,764	97,764
Loans receivable, net	3,717,501	3,566,834
Property, plant and equipment, net of accumulated depreciation of $1,597,284 and $1,538,836	2,582,633	2,542,776
Regulatory assets	110,611	110,718
Other	443,294	456,134
Goodwill and other intangibles, net	88,598	89,580
	$ 10,020,728	$ 9,951,577
Liabilities and stockholders equity		
Liabilities		
Accounts payable	$ 188,241	$ 183,336
Deposit liabilities	4,546,855	4,557,419
Short-term borrowings	296,493	141,758
Other borrowings	1,671,655	1,622,294
Long-term debt, net	1,033,089	1,142,993
Deferred income taxes	183,420	207,997
Regulatory liabilities	229,928	219,204
Contributions in aid of construction	262,036	256,263
Other	369,577	369,390
	8,781,294	8,700,654
Minority interests		
Preferred stock of subsidiaries - not subject to mandatory redemption	34,293	34,293
Stockholders equity		
Preferred stock, no par value, authorized 10,000,000 shares; issued: none		
Common stock, no par value, authorized 100,000,000 shares; issued and outstanding: 81,275,371 shares and 80,983,326 shares	1,023,564	1,018,966
Retained earnings	244,645	235,394
Accumulated other comprehensive loss, net of tax benefits	(63,068)	(37,730)
	1,205,141	1,216,630
	$ 10,020,728	$ 9,951,577

See accompanying Notes to Consolidated Financial Statements for HEI.

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Hawaiian Electric Industries, Inc. and Subsidiaries

Consolidated Statements of Income (unaudited)

(in thousands, except per share amounts and ratio of earnings to fixed charges)	Three months ended June 30 2006	Three months ended June 30 2005	Six months ended June 30 2006	Six months ended June 30 2005
Revenues				
Electric utility	$ 503,967	$ 429,730	$ 979,023	$ 804,505
Bank	102,556	91,946	202,560	189,170
Other	(1,554)	586	(1,652)	1,215
	604,969	**522,262**	**1,179,931**	**994,890**
Expenses				
Electric utility	464,121	387,083	893,597	730,252
Bank	76,397	69,744	149,386	138,015
Other	3,722	3,986	7,068	8,503
	544,240	**460,813**	**1,050,051**	**876,770**
Operating income (loss)				
Electric utility	39,846	42,647	85,426	74,253
Bank	26,159	22,202	53,174	51,155
Other	(5,276)	(3,400)	(8,720)	(7,288)
	60,729	**61,449**	**129,880**	**118,120**
Interest expense other than bank	(19,134)	(19,130)	(38,251)	(37,965)
Allowance for borrowed funds used during construction	719	475	1,421	902
Preferred stock dividends of subsidiaries	(473)	(474)	(946)	(950)
Allowance for equity funds used during construction	1,588	1,182	3,136	2,269
Income from continuing operations before income taxes	**43,429**	**43,502**	**95,240**	**82,376**
Income taxes	16,205	15,167	35,679	29,946
Income from continuing operations	**27,224**	**28,335**	**59,561**	**52,430**
Discontinued operations-loss on disposal, net of income taxes		**(755)**		**(755)**
Net income	**$ 27,224**	**$ 27,580**	**$ 59,561**	**$ 51,675**
Basic earnings (loss) per common share				
Continuing operations	$ 0.34	$ 0.35	$ 0.73	$ 0.65
Discontinued operations		(0.01)		(0.01)
	$ 0.34	$ 0.34	$ 0.73	$ 0.64
Diluted earnings (loss) per common share				
Continuing operations	$ 0.33	$ 0.35	$ 0.73	$ 0.65
Discontinued operations		(0.01)		(0.01)
	$ 0.33	$ 0.34	$ 0.73	$ 0.64

Dividends per common share	$	0.31	$	0.31	$	0.62	$	0.62
Weighted-average number of common shares outstanding		81,100		80,814		81,041		80,741
Dilutive effect of stock options and dividend equivalents		332		399		319		404
Adjusted weighted-average shares		81,432		81,213		81,360		81,145
Ratio of earnings to fixed charges (SEC method)								
Excluding interest on ASB deposits						2.21		2.07
Including interest on ASB deposits						1.85		1.81

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)

(in thousands, except per share amounts)	Common stock Shares	Common stock Amount	Retained earnings	Accumulated other comprehensive loss	Total
Balance, December 31, 2005	**80,983**	**$ 1,018,966**	**$ 235,394**	**$ (37,730)**	**$ 1,216,630**
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 ($0.62 per share)			(50,310)		(50,310)
Balance, June 30, 2006	**81,275**	**$ 1,023,564**	**$ 244,645**	**$ (63,068)**	**$ 1,205,141**
Balance, December 31, 2004	**80,687**	**$ 1,010,090**	**$ 208,998**	**$ (8,143)**	**$ 1,210,945**
Comprehensive income:					
Net income			51,675		51,675
Net unrealized losses on securities:					
Net unrealized losses on securities arising during the period, net of tax benefits of $4,881				(3,510)	(3,510)
Less: reclassification adjustment for net realized gains included in net income, net of taxes of $70				(106)	(106)
Comprehensive income (loss)			51,675	(3,616)	48,059
Issuance of common stock, net	247	7,182			7,182
Common stock dividends ($0.62 per share)			(50,100)		(50,100)
Balance, June 30, 2005	**80,934**	**$ 1,017,272**	**$ 210,573**	**$ (11,759)**	**$ 1,216,086**

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	**2006**	**2005**
(in thousands)		
Cash flows from operating activities		
Net income	$ 59,561	$ 51,675
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation of property, plant and equipment	70,574	66,974
Other amortization	4,211	5,861
Reversal of allowance for loan losses		(3,100)
Deferred income taxes	(7,498)	2,066
Allowance for equity funds used during construction	(3,136)	(2,269)
Excess tax benefits from share-based payment arrangements	(567)	
Changes in assets and liabilities, net of effects from the disposal of businesses		
Decrease (increase) in accounts receivable and unbilled revenues, net	1,656	(3,895)
Decrease (increase) in federal tax deposit	30,000	(30,000)
Increase (decrease) in accounts payable	4,905	(7,921)
Changes in other assets and liabilities	(12,017)	(9,224)
Net cash provided by operating activities	**147,689**	**70,167**
Cash flows from investing activities		
Available-for-sale investment and mortgage-related securities purchased	(175,000)	(174,436)
Principal repayments on available-for-sale mortgage-related securities	254,109	353,425
Proceeds from sale of available-for-sale mortgage-related securities		28,039
Net increase in loans held for investment	(159,096)	(179,326)
Capital expenditures	(97,691)	(86,146)
Contributions in aid of construction	10,622	5,444
Other	1,436	1,144
Net cash used in investing activities	**(165,620)**	**(51,856)**
Cash flows from financing activities		
Net increase (decrease) in deposit liabilities	(10,564)	157,150
Net increase in short-term borrowings with maturities of three months or less	109,845	50,277
Proceeds from short-term borrowings with maturities of greater than three months	44,890	
Net increase in retail repurchase agreements	21,650	8,713
Proceeds from other borrowings	635,840	683,205
Repayments of other borrowings	(608,595)	(806,331)
Proceeds from issuance of long-term debt		53,643
Repayment of long-term debt	(110,000)	(53,000)
Excess tax benefits from share-based payment arrangements	567	
Net proceeds from issuance of common stock	2,481	2,918
Common stock dividends	(50,282)	(50,073)
Other	(7,628)	(10,212)
Net cash provided by financing activities	**28,204**	**36,290**
Cash flows from discontinued operations-net cash provided by (used in) operating activities (revised see Note 8)	**6,846**	**(1,836)**
Net increase in cash and equivalents and federal funds sold	17,119	52,765

Cash and equivalents and federal funds sold, beginning of period	208,947	173,629
Cash and equivalents and federal funds sold, end of period	**$ 226,066**	**$ 226,394**

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 accounting principles generally accepted in the United States of America (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, 2005 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, 2006.

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, 2006 and December 31, 2005 and the results of its operations for the three and six months ended June 30, 2006 and 2005 and its cash flows for the six months ended June 30, 2006 and 2005. 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.

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(2) Segment financial information

(in thousands)	Electric Utility	Bank	Other	Total
Three months ended June 30, 2006				
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
Income (loss) from continuing operations	17,286	16,218	(6,280)	27,224
Six months ended June 30, 2006				
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
Income (loss) from continuing operations	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
Three months ended June 30, 2005				
Revenues from external customers	$ 429,683	$ 91,946	$ 633	$ 522,262
Intersegment revenues (eliminations)	47		(47)	
Revenues	429,730	91,946	586	522,262
Profit (loss)*	31,890	22,183	(10,571)	43,502
Income taxes (benefit)	12,246	8,631	(5,710)	15,167
Income (loss) from continuing operations	19,644	13,552	(4,861)	28,335
Six months ended June 30, 2005				
Revenues from external customers	804,458	189,170	1,262	994,890
Intersegment revenues (eliminations)	47		(47)	
Revenues	804,505	189,170	1,215	994,890
Profit (loss)*	51,973	51,106	(20,703)	82,376
Income taxes (benefit)	19,944	19,793	(9,791)	29,946
Income (loss) from continuing operations	32,029	31,313	(10,912)	52,430
Assets (at June 30, 2005, including net assets of discontinued operations)	2,923,097	6,816,549	67,425	9,807,071

* 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.

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(3) Electric utility subsidiary

For HECO s consolidated financial information, including its commitments and contingencies, see pages 15 through 35.

(4) Bank subsidiary

Selected financial information

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

Consolidated Balance Sheet Data (unaudited)

(in thousands)	June 30, 2006	December 31, 2005
Assets		
Cash and equivalents	$ 139,539	$ 150,130
Federal funds sold	81,121	57,434
Available-for-sale investment and mortgage-related securities	2,506,444	2,629,351
Investment in stock of Federal Home Loan Bank of Seattle, at cost	97,764	97,764
Loans receivable, net	3,717,501	3,566,834
Other	235,950	244,443
Goodwill and other intangibles, net	88,475	89,379
	$ 6,866,794	$ 6,835,335
Liabilities and stockholder s equity		
Deposit liabilities noninterest-bearing	$ 624,246	$ 624,497
Deposit liabilities interest-bearing	3,922,609	3,932,922
Other borrowings	1,671,655	1,622,294
Other	100,944	98,189
	6,319,454	6,277,902
Common stock	322,318	321,538
Retained earnings	286,997	272,545
Accumulated other comprehensive loss, net of tax benefits	(61,975)	(36,650)
	547,340	557,433
	$ 6,866,794	$ 6,835,335

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

Consolidated Statements of Income Data (unaudited)

	Three months ended		Six months ended	
	June 30		June 30	
(in thousands)	2006	2005	2006	2005
Interest and dividend income				
Interest and fees on loans	$ 57,323	$ 50,657	$ 112,476	$ 99,170
Interest and dividends on investment and mortgage-related securities	30,870	27,523	60,947	62,386
	88,193	78,180	173,423	161,556
Interest expense				
Interest on deposit liabilities	17,001	12,460	32,394	24,477
Interest on other borrowings	18,308	16,893	35,470	34,641
	35,309	29,353	67,864	59,118
Net interest income	**52,884**	**48,827**	**105,559**	**102,438**
Reversal of allowance for loan losses				(3,100)
Net interest income after reversal of allowance for loan losses	**52,884**	**48,827**	**105,559**	**105,538**
Noninterest income				
Fees from other financial services	6,742	6,333	13,182	12,196
Fee income on deposit liabilities	4,376	4,092	8,565	8,263
Fee income on other financial products	2,132	2,154	4,569	4,589
Gain on sale of securities		175		175
Other income	1,113	1,012	2,821	2,391
	14,363	13,766	29,137	27,614
Noninterest expense				
Compensation and employee benefits	17,476	17,441	35,313	34,068
Occupancy	4,490	4,088	8,953	8,106
Equipment	3,636	3,302	7,132	6,701
Services	4,124	3,941	7,841	7,608
Data processing	2,547	2,503	5,007	5,548
Other expenses	8,815	9,116	17,276	19,966
	41,088	40,391	81,522	81,997
Income before minority interests and income taxes	**26,159**	**22,202**	**53,174**	**51,155**
Minority interests		18		45
Income taxes	9,941	8,631	20,129	19,793
Income before preferred stock dividends	**16,218**	**13,553**	**33,045**	**31,317**
Preferred stock dividends		1		4
Net income for common stock	**$ 16,218**	**$ 13,552**	**$ 33,045**	**$ 31,313**

Other borrowings consisted of securities sold under agreements to repurchase and advances from the Federal Home Loan Bank (FHLB) of Seattle of $834 million and $838 million, respectively, as of June 30, 2006 and $687 million and $935 million, respectively, as of December 31, 2005.

As of June 30, 2006, ASB had commitments to borrowers for undisbursed loan funds, loan commitments and unused lines and letters of credit of $1.2 billion. As of June 30, 2006, ASB had commitments to sell nonresidential loans of $12.9 million.

In the first quarter of 2005, ASB recorded a $2 million reserve, net of taxes, for interest on the potential taxes related to the disputed timing of dividend income recognition because of a change in ASB s 2000 and 2001 tax year-ends (see Note 10).

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(5) Retirement benefits

For the first six months of 2006, ASB paid $2 million and HECO paid $5 million of contributions to the retirement benefit plans, compared to $6 million and $5 million, respectively, in the first six months of 2005. The Company s current estimate of contributions to the retirement benefit plans in 2006 is $14 million, compared to contributions of $25 million in 2005.

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	
(in thousands)	2006	2005	2006	2005	2006	2005	2006	2005
Service cost	$ 8,236	$ 7,390	$ 1,278	$ 1,345	$ 16,327	$ 14,673	$ 2,549	$ 2,618
Interest cost	13,645	13,031	2,578	2,744	27,121	26,089	5,310	5,552
Expected return on plan assets	(18,089)	(18,535)	(2,493)	(2,440)	(35,842)	(36,909)	(4,959)	(4,925)
Amortization of unrecognized transition obligation	1	1	785	785	2	2	1,569	1,569
Amortization of prior service cost (gain)	14	(165)	4	(3)	(142)	(311)	7	
Recognized actuarial loss (gain)	2,917	1,402	(18)	72	6,028	2,996	206	231
Net periodic benefit cost	$ 6,724	$ 3,124	$ 2,134	$ 2,503	$ 13,494	$ 6,540	$ 4,682	$ 5,045

Of the net periodic benefit costs, the Company recorded expense of $14 million and $9 million in the first six months of 2006 and 2005, respectively, and charged the remaining amounts primarily to electric utility plant.

(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 (5,158,493 shares unissued as of June 30, 2006) 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 NQSOs, restricted stock, SARs, and dividend equivalents. 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 equals 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 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 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.

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 method of accounting.

The Company recorded share-based compensation expense in the first six months of 2006 and 2005 of $0.9 million and $2.8 million, respectively. In the second quarter of 2006 and 2005, the Company recorded share-based compensation expense of $0.3 million and $1.6 million, respectively. The Company recorded related income tax benefit (including a valuation allowance due to limits on the deductibility of executive compensation) on share-based compensation expense in the first six months of 2006 and 2005 of $0.5 million and $0.9 million, respectively. In the second quarter of 2006 and 2005, the Company recorded related income tax benefit of $0.3 million, and $0.6 million, respectively. No share-based compensation cost has been capitalized.

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Also, as a result of the changes enacted in Section 409A of the Internal Revenue Code of 1986, as amended (Section 409A) in December 2005, a total of 61,482 dividend equivalent shares were distributed to SOIP participants in February 2006 for the NQSO grants made from 2001 to 2003 and the SARs grants made from 2004 to 2005. The gross amount of 69,737 dividend equivalent shares subject to Section 409A was reduced by 8,255 shares because the exercise prices of the SARs grants exceeded the value of the underlying common stock as of December 31, 2005. The intrinsic value of the Section 409A dividend equivalent distribution was $1.6 million. The Company recorded related income tax benefits of $0.6 million. During the second quarter of 2006, 10,236 dividend equivalent shares subject to Section 409A, with an intrinsic value of $0.3 million and related tax benefit of $0.1 million, were distributed to SOIP participants who retired. At the election of SOIP participants, retirees may take distributions of dividend equivalents subject to Section 409A at the time of retirement rather than at the end of the calendar year.

In place of a SARs grant for 2006, as described under Restricted stock, the Company instead awarded restricted stock. For all share-based compensation, the estimated forfeiture rate is 1.4%.

Nonqualified stock options

Information about HEI s NQSOs is summarized as follows:

June 30, 2006			Outstanding			Exercisable	
Year of grant	Range of exercise prices	Number of options	Weighted-average remaining contractual life	Weighted-average exercise price	Number of options	Weighted-average remaining contractual life	Weighted-average exercise price
1998	$20.50	6,000	1.8	$ 20.50	6,000	1.8	$ 20.50
1999	17.61 -17.63	65,000	3.0	17.62	65,000	3.0	17.62
2000	14.74	52,000	3.8	14.74	52,000	3.8	14.74
2001	17.96	138,500	4.7	17.96	138,500	4.7	17.96
2002	21.68	150,000	5.7	21.68	150,000	5.7	21.68
2003	20.49	401,000	5.8	20.49	321,000	5.5	20.49
	$14.74 21.68	812,500	5.2	$ 19.68	732,500	5.0	$ 19.59

As of December 31, 2005, NQSOs outstanding totaled 929,000, with a weighted-average exercise price of $19.88. In the second quarter of 2006 and 2005, no NQSOs were granted, forfeited or expired; 197,500 shares and 277,000 shares vested with an aggregate fair value of $0.9 million and $1.2 million, respectively. In the first quarter of 2006 and 2005, no NQSOs were granted, vested, forfeited or expired.

During the first six months of 2006, 116,500 shares were exercised, with a weighted-average exercise price of $21.30. Cash received from these exercises was $2.5 million and the intrinsic value (amount by which the fair market value of the underlying stock and the related dividend equivalents exceeds the exercise price of the option) of the shares was $1.2 million. The tax benefit realized for the tax deduction from these exercises was $0.5 million. During the second quarter of 2006, 110,500 shares were exercised, with a weighted-average exercise price of $21.52. Cash received from these exercises was $2.4 million and the intrinsic value of the shares was $1.1 million. The tax benefit realized for the tax deduction from these exercises was $0.4 million.

During the second quarter of 2005, 153,500 shares were exercised, with a weighted-average exercise price of $19.01. Cash received from these exercises was $2.9 million and the intrinsic value of the shares was $1.8 million. The tax benefit realized for the tax deduction from these exercises was $0.4 million. There were no exercises in the first quarter of 2005.

As of June 30, 2006, NQSO shares outstanding and exercisable had an aggregate intrinsic value (including dividend equivalents) of $10.5 million and $9.7 million, respectively.

As of June 30, 2006, there was $0.2 million of total unrecognized compensation cost related to nonvested NQSOs and that cost is expected to be recognized over a weighted average period of 10 months.

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Stock appreciation rights

Information about HEI s SARs is summarized as follows:

June 30, 2006		Outstanding			Exercisable		
Year of grant	Range of exercise prices	Number of shares underlying SARs	Weighted-average remaining contractual life	Weighted-average exercise price	Number of shares underlying SARs	Weighted-average remaining contractual life	Weighted-average exercise price
2004	$26.02	325,000	5.6	$ 26.02	235,000	4.8	$ 26.02
2005	26.18	554,000	7.1	26.18	160,000	2.9	26.18
	$26.02 26.18	879,000	6.5	$ 26.12	395,000	4.0	$ 26.08

As of December 31, 2005, the shares underlying SARs outstanding totaled 879,000, with a weighted-average exercise price of $26.12. As of June 30, 2006, the SARs outstanding and exercisable had an aggregate intrinsic value (including dividend equivalents) of $2.5 million and $1.0 million, respectively. During the first six months of 2006, no SARs were granted, exercised, forfeited or expired; 313,750 shares vested with a fair value of $1.7 million. In the first quarter of 2006, no SARs were granted, vested, forfeited or expired. During the first six months of 2005 554,000 SARs shares were granted, 24,000 shares were exercised, no shares were forfeited or expired; 105,250 shares vested with a fair value of $0.5 million. In the first quarter of 2005, no SARs were granted, vested, forfeited or expired.

During the second quarter of 2005, 24,000 SARs were exercised, with an exercise price of $26.02. The intrinsic value of this exercise (amount by which the fair market value of the underlying stock and the related dividend equivalents exceeds the exercise price of the option) of the shares was $9,500. The tax benefit realized for the tax deduction from this exercise was $4,000.

As of June 30, 2006, there was $1.4 million of total unrecognized compensation cost related to SARs and that cost is expected to be recognized over a weighted average period of 2.6 years.

The weighted-average fair value of each of the SARs granted during 2005 was $5.82 (at grant date). For 2005, the weighted-average assumptions used to estimate fair value include: risk-free interest rate of 4.1%, expected volatility of 18.1%, expected dividend yield of 5.9%, term of 10 years and expected life of 4.5 years. The weighted-average fair value of the SARs grant is estimated on the date of grant using a Binomial Option Pricing Model. See below for discussion of 2005 grant modification. The expected volatility is based on historical price fluctuations. The Company believes that historical volatility is appropriate based upon the Company s business model and strategies.

Section 409A modification

As noted above, in December 2005, to comply with Section 409A, HEI modified certain provisions pertaining to the dividend equivalent rights attributable to the outstanding grants of NQSOs and SARs held by 40 employees under the 1987 HEI Stock Option and Incentive Plan, as amended. The modifications apply to the NQSOs granted in 2001, 2002, and 2003 and the SARs granted in 2004 and 2005 and in general accelerate the distribution of dividend equivalent shares earned after 2004. When a share-based award is modified, the Company recognizes the incremental compensation cost, which is measured as the excess, if any, of the fair value of the modified award over the fair value of the original award immediately before its terms are modified.

The assumptions used to estimate fair value at the time of the Section 409A modification for the 2005 SARs include: risk-free interest rate of 4.4%, expected volatility of 14.9%, original term of 10 years and expected dividend yield of 4.6%. The expected life used at the time of modification was 4.2 years for 2005. As of December 7, 2005, the fair value of modified 2005 SARs, the fair value of original 2005 SARs and the additional compensation cost to be recognized per grant was $5.07, $4.95 and $0.12, respectively. The additional compensation cost for the Section 409A modification was not material.

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Restricted stock

As of December 31, 2005, restricted stock shares outstanding totaled 41,000, with a weighted-average grant date fair value of $23.50. As of June 30, 2006, restricted stock shares outstanding totaled 101,800, with a weighted-average grant date fair value of $25.18. The 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 2006, no restricted stock shares vested or were forfeited; 60,800 shares with a fair market value of $1.6 million were granted. In the first quarter of 2006, no restricted stock shares were granted, vested, or forfeited. During the first six months of 2005, no restricted stock shares vested or were forfeited; 9,000 shares with a fair market value of $0.2 million were granted. In the first quarter of 2005, no restricted stock shares were granted, vested, or forfeited.

The tax benefit realized for the tax deductions from restricted stock dividends were immaterial for the first six months of 2006 and 2005.

As of June 30, 2006, there was $1.8 million of total unrecognized compensation cost related to nonvested restricted stock. The cost is expected to be recognized over a period of 3.7 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.

(8) Cash flows

Supplemental disclosures of cash flow information

For the six months ended June 30, 2006 and 2005, the Company paid interest amounting to $94.9 million and $88.4 million, respectively.

For the six months ended June 30, 2006 and 2005, the Company paid income taxes amounting to $3.9 million and $19.5 million (including payment of bank franchise taxes and federal income taxes related to a prior year settlement), respectively.

Supplemental disclosures of noncash activities

Noncash increases in common stock for director and officer compensatory plans were $1.5 million and $4.2 million for the six months ended June 30, 2006 and 2005, respectively.

Revised cash flows from discontinued operations

The Company has separately disclosed the operating, investing and financing portions of the cash flows attributable to its discontinued operations for the first six months of 2006, which in the first six months of 2005 were reported on a combined basis as a single amount. For the first six months of 2006 and 2005, there were no cash flows from investing and financing activities from the Company s discontinued operations.

(9) Recent accounting pronouncements and interpretations

For a discussion of a recent accounting pronouncement regarding variable interest entities (VIEs), see Note 7 of HECO s Notes to Consolidated Financial Statements.

Share-based payment

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment, which requires companies to recognize the grant-date fair value of stock options and other equity-based compensation issued to employees in the income statement. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, which provides accounting, disclosure, valuation and other guidance related to share-based payment arrangements. The Company adopted the provisions of SFAS No. 123 (revised 2004) using a modified prospective application and the guidance in SAB No. 107 on January 1, 2006 and the net income impact of adoption was immaterial. Since the Company adopted the recognition provisions of SFAS No. 123 as of January 1, 2002, the only expense recognition change the Company made upon adoption of SFAS No. 123 (revised 2004) was how it accounts for forfeitures. The average annual forfeiture rate for 1996 through 2005 was 1.4% and historically has not been significant. In accordance with SFAS No. 123 (revised 2004), expanded disclosures are included in Note 6.

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Accounting for certain hybrid financial instruments

In March 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. This statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. The Company will adopt SFAS No. 155 on January 1, 2007. Because the impact of adopting the provisions of SFAS No. 155 will be dependent on future events and circumstances, management cannot predict such impact.

Accounting for servicing of financial assets

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets. This statement amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement requires an entity to recognize in certain situations a servicing asset or servicing liability when it undertakes an obligation to service a financial asset, requires all separately recognized servicing assets and liabilities to be initially measured at fair value (if practicable), permits alternative subsequent measurement methods for each class of servicing assets and liabilities, permits a limited one-time reclassification of available-for-sale securities to trading securities at adoption, requires separate presentation of servicing assets and liabilities subsequently measured at fair value in the balance sheet and requires additional disclosures. SFAS No. 156 must be adopted by the beginning of the first fiscal year that begins after September 15, 2006. The Company will adopt SFAS No. 156 on January 1, 2007 and management does not expect the impact of the adoption of the provisions will be material to the Company s financial statements.

Accounting for uncertainty in income taxes

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. This interpretation 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 settlement with tax authorities) for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN No. 48 on January 1, 2007 and has not yet determined the impact of these provisions on the Company s results of operations, financial condition or liquidity.

Cash flows relating to income taxes generated by a leveraged lease transaction

In July 2006, the FASB issued FASB Staff Position (FSP) No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction, which requires a recalculation of the rate of return and the allocation of income to positive investment years from the inception of the lease if there is a change or projected change in the timing of cash flows relating to income taxes generated by the leveraged lease. The amounts comprising the net leveraged lease investment would be adjusted to the recalculated amounts, and the change in the net investment would be recognized as a gain or loss in the year in which the projected cash flows and/or assumptions change. FSP No. 13-2 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FSP No. 13-2 on January 1, 2007. Based on current circumstances, the adoption of the provisions of FSP No. 13-2 will have no effect on the Company s financial statements.

(10) Income taxes

In the first quarter of 2005, the Company recorded a $2 million reserve, net of taxes, for interest on the potential taxes related to the disputed timing of dividend income recognition because of a change in ASB s 2000 and 2001 tax year-ends. In the second quarter of 2005, the Company made a $30 million deposit primarily to stop the further accrual of interest on the potential taxes related to the disputed timing of dividend income recognition. Also in the second quarter of 2005, $1 million of income taxes and interest payable, net of taxes, were reversed due to the resolution of audit issues with the Internal Revenue Service (IRS). In the fourth quarter of 2005, additional IRS audit issues were resolved, resulting in the reversal of $1 million of interest, net of taxes.

As of June 30, 2006, $1 million, net of tax effects, was reserved for potential tax issues and related interest. Although not probable, adverse developments on potential tax issues could result in additional charges to net income in the future. Based on information currently available, the Company believes it has adequately provided for potential income tax issues with federal and state tax authorities and related interest, and that the ultimate resolution of tax issues for all open tax periods will not have a material adverse effect on its results of operations, financial condition or liquidity.

(11) Investment in Hoku Scientific, Inc.

As of June 30, 2006, HEI Properties, Inc. (HEIPI) held shares of Hoku Scientific, Inc. (Hoku), a Hawaii fuel cell technology startup company. Prior to August 5, 2005, the investment had been accounted for under the cost method. Hoku went public and shares of Hoku began trading on the Nasdaq Stock Market on August 5, 2005. HEIPI was subject to certain lockup provisions that expired in February 2006. Since August 5, 2005, Hoku shares have been considered marketable and HEIPI has classified the shares as trading securities, carried at fair value with changes in fair value recorded in earnings. In the three and six months ended June 30, 2006, HEIPI recognized a $1.2 million loss (unrealized, net of taxes) and a $1.6 million loss (unrealized and realized, net of taxes), respectively, on the Hoku shares. As of June 30, 2006, HEIPI had sold 11% of its Hoku shares and carried its remaining investment in Hoku shares at $2 million.

(12) Credit agreements

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 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. Annual fees on undrawn commitments are 10 basis points. The agreement contains customary conditions which must be met in order to draw on it, including the continued accuracy of HEI s representations and compliance with its covenants. In addition to customary defaults, HEI s failure to maintain its nonconsolidated Capitalization Ratio (funded debt) of 50% or less and Consolidated Net Worth of $850 million, as defined in its agreement, or meet other requirements will result in an event of default.

Also effective April 3, 2006, HEI entered into a $75 million bilateral revolving unsecured credit agreement with Merrill Lynch Bank USA, which expires on December 27, 2006. Any draws on the facility bear interest, at the option of HEI, at the Adjusted LIBO Rate plus 57.5 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 agreement s conditions precedent to drawing on the line and events of default are similar to HEI s $100 million revolving unsecured credit agreement.

These two facilities, currently totaling $175 million, are maintained to support the issuance of commercial paper, but also may be drawn for general corporate purposes. The facilities contain provisions for revised pricing in the event of a ratings change and replaced HEI s four bilateral bank lines of credit totaling $80 million, which were terminated concurrently with the effectiveness of the new facilities. The Company used the new facilities to support the issuance of commercial paper to refinance $100 million of its Series C medium-term notes, which matured on April 10, 2006. As of July 31, 2006, the $175 million of credit facilities were 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 Balance Sheets (unaudited)

(in thousands, except par value)	June 30, 2006	December 31, 2005
Assets		
Utility plant, at cost		
Land	$ 35,034	$ 33,034
Plant and equipment	3,846,892	3,749,386
Less accumulated depreciation	(1,509,529)	(1,456,537)
Plant acquisition adjustment, net	119	145
Construction in progress	140,384	147,756
Net utility plant	2,512,900	2,473,784
Current assets		
Cash and equivalents	3,374	143
Customer accounts receivable, net	126,198	123,895
Accrued unbilled revenues, net	88,355	91,321
Other accounts receivable, net	6,054	14,761
Fuel oil stock, at average cost	113,474	85,450
Materials and supplies, at average cost	30,124	26,974
Prepaid pension benefit cost	96,330	106,318
Other	9,214	8,584
Total current assets	473,123	457,446
Other long-term assets		
Regulatory assets	110,611	110,718
Unamortized debt expense	14,005	14,361
Other	28,516	25,152
Total other long-term assets	153,132	150,231
	$ 3,139,155	$ 3,081,461
Capitalization and liabilities		
Capitalization		
Common stock, $6 2/3 par value, authorized 50,000 shares; outstanding 12,806 shares	$ 85,387	$ 85,387
Premium on capital stock	299,186	299,186
Retained earnings	663,579	654,686
Common stock equity	1,048,152	1,039,259
Cumulative preferred stock not subject to mandatory redemption	34,293	34,293
Long-term debt, net	766,089	765,993
Total capitalization	1,848,534	1,839,545
Current liabilities		
Short-term borrowings nonaffiliates	163,476	136,165
Accounts payable	121,995	122,201

Interest and preferred dividends payable	11,484	9,990
Taxes accrued	143,306	133,583
Other	34,154	37,132
Total current liabilities	474,415	439,071
Deferred credits and other liabilities		
Deferred income taxes	201,462	208,374
Regulatory liabilities	229,928	219,204
Unamortized tax credits	57,157	55,327
Other	65,623	63,677
Total deferred credits and other liabilities	554,170	546,582
Contributions in aid of construction	262,036	256,263
	$ 3,139,155	$ 3,081,461

See accompanying Notes to Consolidated Financial Statements for HECO.

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Hawaiian Electric Company, Inc. and Subsidiaries

Consolidated Statements of Income (unaudited)

(in thousands, except for ratio of earnings to fixed charges)	Three months ended June 30 2006	Three months ended June 30 2005	Six months ended June 30 2006	Six months ended June 30 2005
Operating revenues	**$ 503,350**	**$ 428,807**	**$ 977,321**	**$ 802,497**
Operating expenses				
Fuel oil	192,314	148,775	367,652	264,401
Purchased power	122,438	106,369	240,158	207,585
Other operation	47,934	41,794	89,953	83,110
Maintenance	22,382	19,837	39,434	37,775
Depreciation	32,542	30,822	65,075	61,642
Taxes, other than income taxes	46,218	39,293	90,741	75,264
Income taxes	11,020	12,293	24,244	20,031
	474,848	399,183	917,257	749,808
Operating income	**28,502**	**29,624**	**60,064**	**52,689**
Other income				
Allowance for equity funds used during construction	1,588	1,182	3,136	2,269
Other, net	521	777	1,430	1,620
	2,109	1,959	4,566	3,889
Income before interest and other charges	**30,611**	**31,583**	**64,630**	**56,578**
Interest and other charges				
Interest on long-term debt	10,776	10,656	21,554	21,565
Amortization of net bond premium and expense	543	557	1,086	1,113
Other interest charges	2,226	702	4,139	1,775
Allowance for borrowed funds used during construction	(719)	(475)	(1,421)	(902)
Preferred stock dividends of subsidiaries	229	229	458	458
	13,055	11,669	25,816	24,009
Income before preferred stock dividends of HECO	**17,556**	**19,914**	**38,814**	**32,569**
Preferred stock dividends of HECO	270	270	540	540
Net income for common stock	**$ 17,286**	**$ 19,644**	**$ 38,274**	**$ 32,029**
Ratio of earnings to fixed charges (SEC method)			3.16	3.00

Hawaiian Electric Company, Inc. and Subsidiaries

Consolidated Statements of Retained Earnings (unaudited)

(in thousands)	Three months ended June 30 2006	2005	Six months ended June 30 2006	2005
Retained earnings, beginning of period	**$ 662,034**	**$ 635,231**	**$ 654,686**	**$ 632,779**
Net income for common stock	17,286	19,644	38,274	32,029
Common stock dividends	(15,741)	(9,289)	(29,381)	(19,222)
Retained earnings, end of period	**$ 663,579**	**$ 645,586**	**$ 663,579**	**$ 645,586**

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 Statements of Cash Flows (unaudited)

Six months ended June 30	**2006**	**2005**
(in thousands)		
Cash flows from operating activities		
Income before preferred stock dividends of HECO	$ 38,814	$ 32,569
Adjustments to reconcile income before preferred stock dividends of HECO to net cash provided by operating activities		
Depreciation of property, plant and equipment	65,075	61,642
Other amortization	3,801	4,568
Deferred income taxes	(6,912)	1,336
Tax credits, net	2,459	1,385
Allowance for equity funds used during construction	(3,136)	(2,269)
Changes in assets and liabilities		
Decrease in accounts receivable	6,404	599
Decrease (increase) in accrued unbilled revenues	2,966	(1,322)
Increase in fuel oil stock	(28,024)	(6,200)
Increase in materials and supplies	(3,150)	(3,579)
Decrease in prepaid pension benefit cost	9,988	3,728
Increase in regulatory assets	(1,587)	(1,167)
Decrease in accounts payable	(206)	(19,551)
Increase (decrease) in taxes accrued	9,723	(109)
Changes in other assets and liabilities	(3,009)	(8,516)
Net cash provided by operating activities	**93,206**	**63,114**
Cash flows from investing activities		
Capital expenditures	(91,394)	(83,516)
Contributions in aid of construction	10,622	5,444
Other	193	1,423
Net cash used in investing activities	**(80,579)**	**(76,649)**
Cash flows from financing activities		
Common stock dividends	(29,381)	(19,222)
Preferred stock dividends	(540)	(540)
Proceeds from issuance of long-term debt		53,643
Repayment of long-term debt		(47,000)
Net increase in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or less	27,311	34,023
Other	(6,786)	(4,925)
Net cash provided by (used in) financing activities	**(9,396)**	**15,979**
Net increase in cash and equivalents	3,231	2,444
Cash and equivalents, beginning of period	143	327
Cash and equivalents, end of period	**$ 3,374**	**$ 2,771**

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, 2005 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, 2006.

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, 2006 and December 31, 2005, the results of their operations for the three and six months ended June 30, 2006 and 2005 and their cash flows for the six months ended June 30, 2006 and 2005. 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 Maui Electric Company, Limited (MECO) and Hawaii Electric Light Company, Inc. (HELCO) 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, MECO and HELCO under an expense agreement and HECO s obligations under its trust guarantee and its guarantee of the obligations of MECO and HELCO 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, 2006 and December 31, 2005 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, 2006 and 2005 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 MECO elect to defer payment of interest on

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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, 2006, HECO and its subsidiaries had six purchase power agreements (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, 2006 totaled $240 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPower totaling $63 million, $87 million, $32 million and $22 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 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 has reviewed its significant PPAs and determined 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 its efforts to obtain from the IPPs the information necessary to make the determinations required under FIN 46R. In January 2005 and 2006, 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 and Kaheawa Wind Power, LLC (KWP) have now provided their information (see below).

If the requested information is ultimately received from the other IPPs, a possible outcome of future analysis is the consolidation of an IPP 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.

Kalaeloa Partners, L.P. In October 1988, HECO entered into a PPA with Kalaeloa, 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, subject to PUC approval, which together effectively increased the firm capacity from 180 MW to 208 MW. The PPA and amendments have been approved by the PUC. 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.

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.

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 Kalealoa 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 which affected 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 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 energy cost adjustment clause to the extent the fuel and fuel related energy payments are not included in base energy rates.

Kaheawa Wind Power, LLC. In December 2004, MECO executed a new PPA with KWP, which recently completed the installation of a 30 MW windfarm on Maui and began selling power to MECO in June 2006. KWP has provided information for MECO to determine if MECO must consolidate KWP, pursuant to the provisions of FIN 46R. Management has concluded that MECO does not have to consolidate KWP as MECO does not have a variable interest in KWP because the PPA does not require MECO to absorb variability of KWP.

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. The PUC approved the restated and amended PPA on March 10, 2005 and it became effective in April 2005. Due to initial problems with securing wind turbines from its supplier, Apollo had earlier informed HELCO that the project may be delayed. However, Apollo informed HELCO in May 2006 that its wind turbine supply problems have been resolved and it can now meet the April 2007 target for commercial operation. The PPA requires Apollo to provide information necessary to (1) determine if HELCO must consolidate Apollo under FIN 46R, (2) consolidate Apollo, if necessary, under FIN 46R, and (3) comply with Section 404 of Sarbanes-Oxley Act of 2002 (SOX). Management is in the process of obtaining the information necessary to complete its determination of whether Apollo is a VIE and, if so, whether HELCO is the primary beneficiary. Based on information currently available, management believes the impact on consolidated HECO s financial statements of the consolidation of Apollo, if necessary, would not be material. However, depending on the magnitude of the capital additions contemplated in the PPA, the impact of a required consolidation of Apollo could be material in the future. If required to consolidate the financial statements of Apollo in the future and such consolidation had a material effect, HECO would retrospectively apply FIN 46R in accordance with SFAS No. 154, Accounting Changes and Error Corrections.

(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, 2006 and 2005, HECO and its subsidiaries included approximately $87 million and $71 million, respectively, of revenue taxes in operating revenues and in taxes, other than income taxes expense.

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(4) Retirement benefits

In each of the first six months of 2006 and 2005, HECO and its subsidiaries paid contributions of $5 million to the retirement benefit plans. HECO and its subsidiaries current estimate of contributions to the retirement benefit plans in 2006 is $10 million, compared to their contributions of $18 million in 2005.

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	
(in thousands)	2006	2005	2006	2005	2006	2005	2006	2005
Service cost	$ 6,819	$ 6,030	$ 1,247	$ 1,307	$ 13,359	$ 11,904	$ 2,482	$ 2,544
Interest cost	12,135	11,722	2,510	2,684	24,174	23,438	5,169	5,420
Expected return on plan assets	(16,301)	(16,812)	(2,452)	(2,402)	(32,233)	(33,462)	(4,879)	(4,850)
Amortization of unrecognized transition obligation			783	783	1	1	1,565	1,565
Amortization of prior service gain	(192)	(197)			(385)	(385)		
Recognized actuarial loss (gain)	2,635	1,145	(19)	59	5,349	2,402	194	206
Net periodic benefit cost	$ 5,096	$ 1,888	$ 2,069	$ 2,431	$ 10,265	$ 3,898	$ 4,531	$ 4,885

Of the net periodic benefit costs, HECO and its subsidiaries recorded expense of $11 million and $6 million in the first six months of 2006 and 2005, respectively, and charged the remaining amounts primarily to electric utility plant.

(5) Commitments and contingencies

Interim increases

On September 27, 2005, the PUC issued an Interim Decision and Order (D&O) 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). The tariff changes implementing the interim rate increase were effective September 28, 2005.

As of June 30, 2006, HECO and its subsidiaries had recognized $57 million of revenues with respect to interim orders ($19 million related to interim orders regarding certain integrated resource planning costs and $38 million related to the interim order with respect to Oahu s general rate increase request described above), 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 HECO s pending rate case, 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 reviews the automatic fuel rate adjustment clause in rate cases, under Act 162, these specific factors must 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 HECO s energy cost adjustment clause (ECAC) that are raised by Act 162. The parties in the rate case proceeding are HECO, the Consumer Advocate, and the federal Department of Defense (DOD).

On June 30, 2006, HECO and the Consumer Advocate filed a stipulation requesting the PUC not to review the Act 162 ECAC issues in this rate case since HECO s application was filed and the record of this proceeding was completed before Act 162 was signed into law, and the settlement agreement entered into by the parties in this rate case included a provision allowing the existing ECAC to be continued. The DOD has indicated it does not object to the stipulation that HECO and the Consumer Advocate filed, and HECO will be working with the parties on an amended stipulation, which all parties would sign.

Management cannot predict whether the PUC will accept the disposition of the Act 162 issue proposed in the stipulation or, if not, the procedural steps or procedural schedule that will be adopted to address the issues that are raised by Act 162, the ultimate outcome of these issues, the effect of these issues on the operation of the ECAC as it relates to the electric utilities or the timing of the PUC s issuance of a final D&O in HECO s pending rate case.

HELCO power situation

Historical context. 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.

Status. Installation of CT-4 and CT-5 was significantly delayed as a result of land use and environmental permitting delays and related administrative proceedings and lawsuits. However, in 2003, the parties opposing the plant expansion project (other than Waimana Enterprises, Inc. (Waimana), which did not participate in the settlement discussions and opposes 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). Subsequently, CT-4 and CT-5 were installed and put into limited commercial operation in May and June 2004, respectively. The Board of Land and Natural Resources (BLNR s) construction deadline of July 31, 2005 has been met. Noise mitigation equipment has been installed on CT-4 and CT-5 and the need for additional noise mitigation work for CT-5 (not requiring any further construction) is being examined 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.

Waimana filed four appeals to the Hawaii Supreme Court from judgments of the Third Circuit Court involving (i) vacating of a November 2002 Final Judgment which had halted construction; (ii) upholding the BLNR 2003 construction period extension; (iii) upholding the BLNR s approval of a revocable permit allowing HELCO to use brackish well water as the primary source of water for operating the Keahole plant; and (iv) upholding the BLNR s approval of the long-term lease allowing HELCO to use brackish well water.

Favorable decisions by the Hawaii Supreme Court have been received on the first three of these appeals. In the first appeal, on May 18, 2006, the Hawaii Supreme Court affirmed the Third Circuit Court s decision vacating the November 2002 Final Judgment which had halted construction. (As a result of the Third Circuit s decision, construction had recommenced in November 2003.) In the second and third appeals, on May 25, 2006 the Hawaii Supreme Court affirmed the Third Circuit Court s decision on the construction period extension and dismissed the appeal of the Third Circuit s judgment upholding the grant of the brackish water revocable permit as moot. The Supreme Court has not yet acted on the fourth appeal.

Full implementation of the Settlement Agreement is conditioned on obtaining final dispositions of all litigation pending at the time of the Settlement Agreement. If the remaining dispositions are obtained in HELCO s favor, then the Settlement Agreement requires 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). Many of these actions have already commenced.

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 was approved in October 2005. In May 2006, HELCO obtained County 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. HELCO will commence construction of ST-7 as other necessary permits, including a building permit, are obtained.

Costs incurred; management s evaluation. As of June 30, 2006, 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, including $43 million for equipment and material purchases, $47 million for planning, engineering, permitting, site development and other costs and $20 million for allowance for funds used during construction (AFUDC) up to November 30, 1998, after which date HELCO has not accrued AFUDC. The $110 million of costs was reclassified from construction in progress to plant and equipment in 2004 and 2005 and depreciated beginning January 1 of the year following the reclassification.

Management believes that the prospects are good that the remaining Settlement Agreement conditions will be satisfied and that any further necessary permits will be obtained and that the remaining appeal will be favorably resolved. However, HELCO s electric rates will not change specifically as a result of including CT-4 and CT-5 in plant and equipment until the PUC grants HELCO rate relief in the rate case commenced by HELCO in May 2006 in part to recover CT-4 and CT-5 costs. Management believes that no adjustment to costs incurred to put CT-4 and CT-5 into service is required as of June 30, 2006. However, if it becomes probable that the PUC will disallow some or all of the incurred costs for rate-making purposes, HELCO may be required to write off a material portion of these costs.

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, but an application for a permit which would have allowed construction in the originally planned route through conservation district lands was denied in June 2002.

HECO continues to believe that the proposed reliability project (the East Oahu Transmission Project) is needed. In December 2003, HECO filed an application with the PUC requesting approval to commit funds (currently estimated at $60 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 has been completed and the PUC issued a Finding of No Significant Impact in April 2005. 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 2008, and the completion date of the second phase is being evaluated.

As of June 30, 2006, the accumulated costs recorded for the EOTP amounted to $28 million, including $12 million of planning and permitting costs incurred prior to 2003, when HECO was denied the approval necessary for the partial underground/partial overhead 138 kV line, $4 million of planning and permitting costs incurred after 2002, and $12 million for AFUDC. In written testimony filed in June 2005, the consultant for the Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii (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 before 2003, and the related 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 evidentiary hearing, the PUC approved that part of a stipulation between HECO and the Consumer Advocate that this proceeding should determine whether HECO should be given approval to expend funds for the EOTP provided 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 that 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. Management believes no adjustment to project costs is required as of June 30, 2006. 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 and 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 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.

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 DOH. Currently, the Participating Parties are preparing Remedial Alternatives Analyses, which will identify and recommend remedial approaches.

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 and of which $0.6 million has been incurred through June 30, 2006). Because (1) the full scope and extent of additional investigative work, remedial activities and monitoring are unknown at this time, (2) the final cost allocation method among the PRPs has not yet been determined and (3) management cannot estimate the costs to be incurred (if any) for the sites other than the Iwilei Unit (including its Honolulu power plant site), the cost estimate may be subject to significant change and additional material investigative and remedial costs may be incurred.

HECO routinely maintains its facilities and has investigated its operations in the Iwilei area and ascertained that they are not releasing petroleum.

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 impacts, if any, on them. If any of the utilities units are ultimately required to install post-combustion control technologies to meet BART emission limits, the resulting capital and operations 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

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impacts. Effective September 9, 2004, the EPA issued a new rule, which establishes location and technology-based design, construction and capacity standards for existing cooling water intake structures. These standards will apply to HECO s Kahe, Waiau and Honolulu generating stations unless the utility can demonstrate that at each facility implementation of these standards will result in costs either significantly higher than the EPA considered in establishing the standards for the facility or significantly greater than the benefits of meeting the standards. In either case, the EPA will then make a case-by-case determination of an appropriate performance standard. HECO has until March 2008 to make this showing or demonstrate compliance. HECO has retained a consultant to develop a cost effective compliance strategy and a preliminary assessment of technologies and operational measures. HECO is developing a monitoring program and plans to perform a cost-benefit analysis to demonstrate that HECO s existing intake systems have minimal environmental impacts, which demonstration would exempt HECO from the standards. Concurrently, HECO will evaluate alternative compliance mechanisms allowed by the rule, some of which could entail significant capital expenditures to implement.

State of Hawaii, *ex rel.*, Bruce R. Knapp, *Qui Tam* Plaintiff, and Beverly Perry, on behalf of herself and all others similarly situated, Class Plaintiff, vs. The AES Corporation, AES Hawaii, Inc., HECO and HEI

In April 2002, HECO and HEI were served with an amended complaint filed in the First Circuit Court of Hawaii alleging that the State of Hawaii and HECO s other customers had been overcharged for electricity by over $1 billion since September 1992 due to alleged excessive prices in the PUC-approved amended PPA between HECO and AES Hawaii, Inc. The PUC proceedings, in which the amended PPA was approved, addressed a number of issues, including whether the terms and conditions of the PPA were reasonable.

As a result of rulings by the First Circuit Court in 2003, all claims for relief and causes of action in the amended complaint were dismissed. In October 2003, plaintiff Beverly Perry filed a notice of appeal on the grounds that the Circuit Court erred in its reliance on the doctrine of primary jurisdiction and the statute of limitations. In May 2006 the Hawaii Supreme Court affirmed the First Circuit Court s rulings on all issues raised in the appeal, and in June 2006, the appellant s motion for reconsideration was denied and the Hawaii Supreme Court filed its Notice and Judgment on Appeal. This closes the case on the merits for all defendants.

Collective bargaining agreements

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 provide for non-compounded wage increases (3% on November 1, 2003; 1.5% on November 1, 2004, May 1, 2005, November 1, 2005 and May 1, 2006; and 3% on November 1, 2006).

(6) Cash flows

Supplemental disclosures of cash flow information

For the six months ended June 30, 2006 and 2005, HECO and its subsidiaries paid interest amounting to $22.7 million and $23.1 million, respectively.

For the six months ended June 30, 2006 and 2005, HECO and its subsidiaries paid income taxes amounting to $5.5 million and $2.9 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 $3.1 million and $2.3 million for the six months ended June 30, 2006 and 2005, respectively.

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(7) Recent accounting pronouncements and interpretations

For a discussion of a recent accounting interpretation regarding uncertainty in income taxes, see Note 9 of HEI s Notes to Consolidated Financial Statements.

Determining the variability to be considered in applying FIN 46R

In April 2006, the FASB issued FSP FIN 46R-6, Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R). This FSP provides guidance in applying FIN 46R, Consolidation of Variable Interest Entities. The variability that is considered can affect the determination of whether an entity is a VIE; which party, if any, is the primary beneficiary of the VIE; and calculations of expected losses and expected residual returns. A company is required to apply the guidance in the FSP prospectively to all entities (including newly created entities) with which that company first becomes involved and to all entities previously required to be analyzed under FIN 46R when a reconsideration event has occurred beginning the first day of the first reporting period beginning after June 15, 2006. HECO and its subsidiaries adopted FSP FIN 46R-6 on July 1, 2006 and the adoption had no effect on HECO and its subsidiaries financial statements.

(8) Income taxes

At June 30, 2006, $0.2 million, net of tax effects, was reserved for potential tax issues and related interest. Although not probable, adverse developments on potential issues could result in additional charges to net income in the future. Based on information currently available, HECO and its subsidiaries believe they have adequately provided for potential income tax issues with federal and state tax authorities and related interest, and that the ultimate resolution of tax issues for all open tax periods will not have a material adverse effect on HECO s consolidated results of operations, financial condition or liquidity.

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

	Three months ended June 30		Six months ended June 30	
(in thousands)	**2006**	**2005**	**2006**	**2005**
Operating income from regulated and nonregulated activities before income taxes (per HEI consolidated statements of income)	$ 39,846	$ 42,647	$ 85,426	$ 74,253
Deduct:				
Income taxes on regulated activities	(11,020)	(12,293)	(24,244)	(20,031)
Revenues from nonregulated activities	(617)	(923)	(1,702)	(2,008)
Add: Expenses from nonregulated activities	293	193	584	475
Operating income from regulated activities after income taxes (per HECO consolidated statements of income)	$ 28,502	$ 29,624	$ 60,064	$ 52,689

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(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. The agreement has an initial term which expires on March 29, 2007, but will automatically extend to 5 years if the longer-term agreement is approved by the PUC. Any draws on the facility bear interest, at the option of HECO, at 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. Annual fees on the undrawn commitments are 8 basis points. The agreement contains provisions for revised pricing in the event of a ratings change and customary conditions that must be met in order to draw on it, including the continued accuracy of HECO s representations and compliance with several covenants. In addition to customary defaults, an event of default would result if HECO fails to maintain a Consolidated Capitalization Ratio (equity) of at least 35%, as defined in its agreement, if HECO s or any of its subsidiaries guarantee of additional indebtedness of the subsidiaries would cause the subsidiary s Consolidated Subsidiary Funded Debt to Capitalization Ratio to exceed 65%, as defined in its agreement, or if HECO fails to meet other requirements.

This facility is maintained to support the issuance of commercial paper, but also may be drawn for capital expenditures and general corporate purposes. This facility replaced HECO s six bilateral bank lines of credit totaling $175 million, which were terminated concurrently with the effectiveness of the new syndicated facility. HECO plans to file with the PUC in the third quarter of 2006 an application seeking approval to extend the termination date of this credit agreement from March 29, 2007, to March 31, 2011. As of July 31, 2006, the $175 million of credit facilities were undrawn.

(11) Consolidating financial information

HECO is not required to provide separate financial statements and 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 Balance Sheet (unaudited)

June 30, 2006

(in thousands)	HECO	HELCO	MECO	RHI	Reclassifications and eliminations	HECO consolidated
Assets						
Utility plant, at cost						
Land	$ 25,777	4,907	4,350			$ 35,034
Plant and equipment	2,378,241	778,940	689,711			3,846,892
Less accumulated depreciation	(926,015)	(288,116)	(295,398)			(1,509,529)
Plant acquisition adjustment, net			119			119
Construction in progress	76,638	14,006	49,740			140,384
Net utility plant	1,554,641	509,737	448,522			2,512,900
Investment in subsidiaries, at equity	387,352				(387,352)	
Current assets						
Cash and equivalents	2,977	330	6	61		3,374
Advances to affiliates	56,600				(56,600)	
Customer accounts receivable, net	84,162	21,898	20,138			126,198
Accrued unbilled revenues, net	60,084	14,313	13,958			88,355
Other accounts receivable, net	4,234	641	1,362		(183)	6,054
Fuel oil stock, at average cost	87,963	8,994	16,517			113,474
Materials and supplies, at average cost	15,019	4,030	11,075			30,124
Prepaid pension benefit cost	75,405	14,157	6,768			96,330
Other	7,477	950	787			9,214
Total current assets	393,921	65,313	70,611	61	(56,783)	473,123
Other long-term assets						
Regulatory assets	81,481	14,153	14,977			110,611
Unamortized debt expense	9,545	2,309	2,151			14,005
Other	21,318	3,406	3,792			28,516
Total other long-term assets	112,344	19,868	20,920			153,132
	$ 2,448,258	594,918	540,053	61	(444,135)	$ 3,139,155
Capitalization and liabilities						
Capitalization						
Common stock equity	$ 1,048,152	190,452	196,884	16	(387,352)	$ 1,048,152
Cumulative preferred stock not subject to mandatory redemption	22,293	7,000	5,000			34,293
Long-term debt, net	481,186	131,027	153,876			766,089
Total capitalization	1,551,631	328,479	355,760	16	(387,352)	1,848,534

Current liabilities						
Short-term borrowings nonaffiliates	163,476					163,476
Short-term borrowings affiliate		50,100	6,500		(56,600)	
Accounts payable	89,855	15,978	16,162			121,995
Interest and preferred dividends payable	7,555	1,863	2,312		(246)	11,484
Taxes accrued	89,246	24,456	29,604			143,306
Other	19,210	3,293	11,543	45	63	34,154
Total current liabilities	369,342	95,690	66,121	45	(56,783)	474,415
Deferred credits and other liabilities						
Deferred income taxes	156,676	24,433	20,353			201,462
Regulatory liabilities	156,670	42,088	31,170			229,928
Unamortized tax credits	32,226	12,883	12,048			57,157
Other	21,864	34,614	9,145			65,623
Total deferred credits and other liabilities	367,436	114,018	72,716			554,170
Contributions in aid of construction	159,849	56,731	45,456			262,036
	$ 2,448,258	594,918	540,053	61	(444,135)	$ 3,139,155

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Hawaiian Electric Company, Inc. and Subsidiaries

Consolidating Balance Sheet (unaudited)

December 31, 2005

					Reclassifications
(in thousands)	**HECO**	**HELCO**	**MECO**	**RHI**	**and**