

HAWAIIAN ELECTRIC CO INC  
Form 10-Q  
November 08, 2012  
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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 September 30, 2012

OR

**o 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. |
|---|------------------------|------------------------------------|
| <b>HAWAIIAN ELECTRIC INDUSTRIES, INC.</b><br>and Principal Subsidiary | 1-8503                 | 99-0208097                         |
| <b>HAWAIIAN ELECTRIC COMPANY, INC.</b>                                | 1-4955                 | 99-0040500                         |

State of Hawaii

(State or other jurisdiction of incorporation or organization)

Hawaiian Electric Industries, Inc. 1001 Bishop Street, Suite 2900, Honolulu, Hawaii 96813

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**Hawaiian Electric Company, Inc. 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 the registrant (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.

Hawaiian Electric Industries Inc. Yes  No

Hawaiian Electric Company, Inc. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Hawaiian Electric Industries Inc. Yes  No

Hawaiian Electric Company, Inc. Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Hawaiian Electric Industries Inc. Yes  No

Hawaiian Electric Company, Inc. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Hawaiian Electric Industries Inc.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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(Do not check if a smaller reporting company)

Hawaiian Electric Company, Inc.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

**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.

| <b>Class of Common Stock</b>                           | <b>Outstanding October 26, 2012</b>     |
|--|---|
| Hawaiian Electric Industries, Inc. (Without Par Value) | 97,500,496 Shares                       |
| Hawaiian Electric Company, Inc. (\$6-2/3 Par Value)    | 14,233,723 Shares (not publicly traded) |

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**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 September 30, 2012

**GLOSSARY OF TERMS**

| <b>Terms</b>             | <b>Definitions</b>   |
|--------------------------|--|
| <b>AFUDC</b>             | Allowance for funds used during construction   |
| <b>AOCI</b>              | Accumulated other comprehensive income   |
| <b>ARO</b>               | Asset retirement obligation  |
| <b>ASB</b>               | American Savings Bank, F.S.B., a wholly-owned subsidiary of American Savings Holdings, Inc.  |
| <b>ASHI</b>              | American Savings Holdings, Inc., a wholly owned subsidiary of Hawaiian Electric Industries, Inc. and the parent company of American Savings Bank, F.S.B.   |
| <b>CIP CT-1 Company</b>  | Campbell Industrial Park 110 MW combustion turbine No. 1<br>Hawaiian Electric Industries, Inc. and its direct and indirect subsidiaries, including, without limitation, Hawaiian Electric Company, Inc. and its subsidiaries (listed under HECO); American Savings Holdings, Inc. and its subsidiary, American Savings Bank, F.S.B.; HEI Properties, Inc.; Hawaiian Electric Industries Capital Trust II and Hawaiian Electric Industries Capital Trust III (inactive financing entities); and The Old Oahu Tug Service, Inc. (formerly Hawaiian Tug & Barge Corp.). |
| <b>Consumer Advocate</b> | Division of Consumer Advocacy, Department of Commerce and Consumer Affairs of the State of Hawaii  |
| <b>DBEDT</b>             | State of Hawaii Department of Business, Economic Development and Tourism   |
| <b>D&amp;O</b>           | Decision and order   |
| <b>Dodd-Frank Act</b>    | Dodd-Frank Wall Street Reform and Consumer Protection Act  |
| <b>DOH</b>               | Department of Health of the State of Hawaii  |
| <b>DRIP</b>              | HEI Dividend Reinvestment and Stock Purchase Plan  |
| <b>DSM</b>               | Demand-side management   |
| <b>ECAC</b>              | Energy cost adjustment clauses   |
| <b>EIP</b>               | 2010 Equity and Incentive Plan   |
| <b>EGU</b>               | Electrical generating unit   |
| <b>Energy Agreement</b>  | Agreement dated October 20, 2008 and signed by the Governor of the State of Hawaii, the State of Hawaii Department of Business, Economic Development and Tourism, the Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs, and HECO, for itself and on behalf of its electric utility subsidiaries committing to actions to develop renewable energy and reduce dependence on fossil fuels in support of the HCEI   |
| <b>EPA</b>               | Environmental Protection Agency federal  |
| <b>EPS</b>               | Earnings per share   |
| <b>EVE</b>               | Economic value of equity   |
| <b>Exchange Act</b>      | Securities Exchange Act of 1934  |
| <b>FDIC</b>              | Federal Deposit Insurance Corporation  |
| <b>federal</b>           | U.S. Government  |
| <b>FHLB</b>              | Federal Home Loan Bank   |
| <b>FHLMC</b>             | Federal Home Loan Mortgage Corporation   |
| <b>FNMA</b>              | Federal National Mortgage Association  |
| <b>FRB</b>               | Federal Reserve Board  |
| <b>FSS</b>               | Forward Starting Swaps   |



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| <b>Terms</b>    | <b>Definitions</b>  |
|-----------------|---|
| <b>GAAP</b>     | U.S. generally accepted accounting principles   |
| <b>GHG</b>      | Greenhouse gas  |
| <b>GNMA</b>     | Government National Mortgage Association  |
| <b>HCEI</b>     | Hawaii Clean Energy Initiative  |
| <b>HECO</b>     | Hawaiian Electric Company, Inc., an electric utility subsidiary of Hawaiian Electric Industries, Inc. and parent company of Hawaii Electric Light Company, Inc., Maui Electric Company, Limited, HECO Capital Trust III (unconsolidated subsidiary), Renewable Hawaii, Inc. and Uluwehiokama Biofuels Corp.                 |
| <b>HEI</b>      | Hawaiian Electric Industries, Inc., direct parent company of Hawaiian Electric Company, Inc., American Savings Holdings, Inc., HEI Properties, Inc., Hawaiian Electric Industries Capital Trust II, Hawaiian Electric Industries Capital Trust III and The Old Oahu Tug Service, Inc. (formerly Hawaiian Tug & Barge Corp.) |
| <b>HEIRSP</b>   | Hawaiian Electric Industries Retirement Savings Plan  |
| <b>HELCO</b>    | Hawaii Electric Light Company, Inc., an electric utility subsidiary of Hawaiian Electric Company, Inc.  |
| <b>HPOWER</b>   | City and County of Honolulu with respect to a power purchase agreement for a refuse-fired plant   |
| <b>IPP</b>      | Independent power producer  |
| <b>Kalaeloa</b> | Kalaeloa Partners, L.P.   |
| <b>KW</b>       | Kilowatt  |
| <b>KWH</b>      | Kilowatthour  |
| <b>LTIP</b>     | Long-term incentive plan  |
| <b>MAP-21</b>   | Moving Ahead for Progress in the 21st Century Act   |
| <b>MECO</b>     | Maui Electric Company, Limited, an electric utility subsidiary of Hawaiian Electric Company, Inc.   |
| <b>MW</b>       | Megawatt/s (as applicable)  |
| <b>NII</b>      | Net interest income   |
| <b>NQSO</b>     | Nonqualified stock option   |
| <b>O&amp;M</b>  | Other operation and maintenance   |
| <b>OCC</b>      | Office of the Comptroller of the Currency   |
| <b>OPEB</b>     | Postretirement benefits other than pensions   |
| <b>PPA</b>      | Power purchase agreement  |
| <b>PPAC</b>     | Purchased power adjustment clause   |
| <b>PUC</b>      | Public Utilities Commission of the State of Hawaii  |
| <b>RAM</b>      | Revenue adjustment mechanism  |
| <b>RBA</b>      | Revenue balancing account   |
| <b>RFP</b>      | Request for proposal  |
| <b>REIP</b>     | Renewable Energy Infrastructure Program   |
| <b>RHI</b>      | Renewable Hawaii, Inc., a wholly owned subsidiary of Hawaiian Electric Company, Inc.  |
| <b>ROACE</b>    | Return on average common equity   |
| <b>RORB</b>     | Return on average rate base   |
| <b>RPS</b>      | Renewable portfolio standard  |
| <b>SAR</b>      | Stock appreciation right  |
| <b>SEC</b>      | Securities and Exchange Commission  |
| <b>See</b>      | Means the referenced material is incorporated by reference  |
| <b>SOIP</b>     | 1987 Stock Option and Incentive Plan, as amended  |
| <b>TDR</b>      | Troubled debt restructuring   |
| <b>UBC</b>      | Uluwehiokama Biofuels Corp., a non-regulated subsidiary of Hawaiian Electric Company, Inc.  |
| <b>VIE</b>      | Variable interest entity  |



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**FORWARD-LOOKING STATEMENTS**

This report and other presentations made by Hawaiian Electric Industries, Inc. (HEI) and Hawaiian Electric Company, Inc. (HECO) and their subsidiaries contain forward-looking statements, which include statements that are predictive in nature, depend upon or refer to future events or conditions, and usually include words such as expects, anticipates, intends, plans, believes, predicts, estimates or similar expressions. In addition, any statements concerning future financial performance, ongoing business strategies or prospects or 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 described in forward-looking statements and from historical results include, but are not limited to, the following:

- international, national and local economic conditions, including the state of the Hawaii tourism, defense and construction industries, the strength or weakness of the Hawaii and continental U.S. real estate markets (including the fair value and/or the actual performance of collateral underlying loans held by American Savings Bank, F.S.B. (ASB), which could result in higher loan loss provisions and write-offs), decisions concerning the extent of the presence of the federal government and military in Hawaii, the implications and potential impacts of U.S. and foreign capital and credit market conditions and federal, state and international responses to those conditions, and the potential impacts of global developments (including global economic conditions and uncertainties, unrest, conflict and the overthrow of governmental regimes in North Africa and the Middle East, terrorist acts, the war on terrorism, continuing U.S. presence in Afghanistan and potential conflict or crisis with North Korea or Iran);
- weather and natural disasters (e.g., hurricanes, earthquakes, tsunamis, lightning strikes and the potential effects of global warming, such as more severe storms and rising sea levels), including their impact on Company operations and the economy (e.g., the effect of the March 2011 natural disasters in Japan on its economy and tourism in Hawaii);
- the timing and extent of changes in interest rates and the shape of the yield curve;
- the ability of the Company to access credit markets to obtain commercial paper and other short-term and long-term debt financing (including lines of credit) and to access capital markets to issue HEI common stock under volatile and challenging market conditions, and the cost of such financings, if available;
- the risks inherent in changes in the value of the Company's pension and other retirement plan assets and ASB's securities available for sale;

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- changes in laws, regulations, market conditions and other factors that result in changes in assumptions used to calculate retirement benefits costs and funding requirements;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) and of the rules and regulations that the Dodd-Frank Act requires to be promulgated;
- increasing competition in the banking industry (e.g., increased price competition for deposits, or an outflow of deposits to alternative investments, which may have an adverse impact on ASB's cost of funds);
- the implementation of the Energy Agreement with the State of Hawaii and Consumer Advocate (Energy Agreement) setting forth the goals and objectives of a Hawaii Clean Energy Initiative (HCEI), revenue decoupling and the fulfillment by the electric utilities of their commitments under the Energy Agreement (given the Public Utilities Commission of the State of Hawaii (PUC) approvals needed; the PUC's potential delay in considering (and potential disapproval of actual or proposed) HCEI-related costs; reliance by the Company on outside parties like the state, independent power producers (IPPs) and developers; potential changes in political support for the HCEI; and uncertainties surrounding wind power, the proposed undersea cables, biofuels, environmental assessments and the impacts of implementation of the HCEI on future costs of electricity);
- capacity and supply constraints or difficulties, especially if generating units (utility-owned or IPP-owned) fail or measures such as demand-side management (DSM), distributed generation, combined heat and power or other firm capacity supply-side resources fall short of achieving their forecasted benefits or are otherwise insufficient to reduce or meet peak demand;
- the risk to generation reliability when generation peak reserve margins on Oahu are strained;
- fuel oil price changes, performance by suppliers of their fuel oil delivery obligations and the continued availability to the electric utilities of their energy cost adjustment clauses (ECACs);
- the impact of fuel price volatility on customer satisfaction and political and regulatory support for the utilities;

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- the risks associated with increasing reliance on renewable energy, as contemplated under the Energy Agreement, including the availability and cost of non-fossil fuel supplies for renewable energy generation and the operational impacts of adding intermittent sources of renewable energy to the electric grid;
- 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) or their competitors;
- cyber security risks and the potential for cyber incidents, including potential incidents at HEI, ASB and HECO and their subsidiaries (including at ASB branches and at the electric utility plants) and incidents at data processing centers they use, to the extent not prevented by intrusion detection and prevention systems, anti-virus software, firewalls and other general information technology controls;
- federal, state, county and international governmental and regulatory actions, such as changes in laws, rules and regulations applicable to HEI, HECO, ASB and their subsidiaries (including changes in taxation, increases in capital requirements, regulatory changes resulting from the HCEI, environmental laws and regulations, the regulation of greenhouse gas (GHG) emissions, governmental fees and assessments (such as Federal Deposit Insurance Corporation assessments), and potential carbon cap and trade legislation that may fundamentally alter costs to produce electricity and accelerate the move to renewable generation);
- decisions by the PUC in rate cases and other proceedings (including the risks of delays in the timing of decisions, adverse changes in final decisions from interim decisions and the disallowance of project costs as a result of adverse regulatory audit reports or otherwise);
- decisions by the PUC and by other agencies and courts on land use, environmental and other permitting issues (such as required corrective actions and restrictions and penalties that may arise, such as with respect to environmental conditions or renewable portfolio standards (RPS));
- potential enforcement actions by the Office of the Comptroller of the Currency, the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC) and/or other governmental authorities (such as consent orders, required corrective actions, restrictions and penalties that may arise, for example, with respect to compliance deficiencies under existing or new banking and consumer protection laws and regulations or with respect to capital adequacy);

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- ability to recover increasing costs and earn a reasonable return on capital investments not covered by revenue adjustment mechanisms;
- the risks associated with the geographic concentration of HEI's businesses and ASB's loans, ASB's concentration in a single product type (i.e., first mortgages) and ASB's significant credit relationships (i.e., concentrations of large loans and/or credit lines with certain customers);
- changes in accounting principles applicable to HEI, HECO, ASB and their subsidiaries, including the possible adoption of International Financial Reporting Standards or new U.S. accounting standards, the potential discontinuance of regulatory accounting and the effects of potentially required consolidation of variable interest entities (VIEs) or required capital lease accounting for PPAs with IPPs;
- 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 assets 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 and charge-offs;
- changes in ASB's deposit cost or mix which may have an adverse impact on ASB's cost of funds;
- the final outcome of tax positions taken by HEI, HECO, ASB and their subsidiaries;
- the risks of suffering losses and incurring liabilities that are uninsured (e.g., damages to the utilities' transmission and distribution system and losses from business interruption) or underinsured (e.g., losses not covered as a result of insurance deductibles or other exclusions or exceeding policy limits); and
- other risks or uncertainties described elsewhere in this report and in other reports (e.g., Item 1A. Risk Factors in the Company's Annual Report on Form 10-K) previously and subsequently filed by HEI and/or HECO with the Securities and Exchange Commission (SEC).

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



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

Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Statements of Income (unaudited)**

| (in thousands, except per share amounts)                                     | Three months<br>ended September 30 |                  | Nine months<br>ended September 30 |                   |
|--|------------------------------------|------------------|-----------------------------------|-------------------|
|  | 2012                               | 2011             | 2012                              | 2011              |
| <b>Revenues</b>  |                                    |                  |                                   |                   |
| Electric utility   | \$ 801,095                         | \$ 820,254       | \$ 2,340,257                      | \$ 2,194,327      |
| Bank   | 66,596                             | 66,100           | 196,569                           | 197,731           |
| Other  | 29                                 | 1                | 22                                | (751)             |
| <b>Total revenues</b>  | <b>867,720</b>                     | <b>886,355</b>   | <b>2,536,848</b>                  | <b>2,391,307</b>  |
| <b>Expenses</b>  |                                    |                  |                                   |                   |
| Electric utility   | 726,276                            | 745,298          | 2,146,688                         | 2,031,645         |
| Bank   | 44,974                             | 42,931           | 130,161                           | 128,988           |
| Other  | 4,768                              | 3,636            | 13,075                            | 9,148             |
| <b>Total expenses</b>  | <b>776,018</b>                     | <b>791,865</b>   | <b>2,289,924</b>                  | <b>2,169,781</b>  |
| <b>Operating income (loss)</b>   |                                    |                  |                                   |                   |
| Electric utility   | 74,819                             | 74,956           | 193,569                           | 162,682           |
| Bank   | 21,622                             | 23,169           | 66,408                            | 68,743            |
| Other  | (4,739)                            | (3,635)          | (13,053)                          | (9,899)           |
| <b>Total operating income</b>  | <b>91,702</b>                      | <b>94,490</b>    | <b>246,924</b>                    | <b>221,526</b>    |
| Interest expense other than on deposit liabilities and other bank borrowings | (20,020)                           | (19,949)         | (58,758)                          | (64,266)          |
| Allowance for borrowed funds used during construction                        | 688                                | 658              | 2,451                             | 1,731             |
| Allowance for equity funds used during construction                          | 1,611                              | 1,570            | 5,548                             | 4,131             |
| <b>Income before income taxes</b>  | <b>73,981</b>                      | <b>76,769</b>    | <b>196,165</b>                    | <b>163,122</b>    |
| Income taxes   | 25,804                             | 27,894           | 69,926                            | 57,700            |
| <b>Net income</b>  | <b>48,177</b>                      | <b>48,875</b>    | <b>126,239</b>                    | <b>105,422</b>    |
| Preferred stock dividends of subsidiaries                                    | 471                                | 471              | 1,417                             | 1,417             |
| <b>Net income for common stock</b>   | <b>\$ 47,706</b>                   | <b>\$ 48,404</b> | <b>\$ 124,822</b>                 | <b>\$ 104,005</b> |
| <b>Basic earnings per common share</b>                                       | <b>\$ 0.49</b>                     | <b>\$ 0.50</b>   | <b>\$ 1.29</b>                    | <b>\$ 1.09</b>    |
| <b>Diluted earnings per common share</b>                                     | <b>\$ 0.49</b>                     | <b>\$ 0.50</b>   | <b>\$ 1.29</b>                    | <b>\$ 1.09</b>    |
| <b>Dividends per common share</b>  | <b>\$ 0.31</b>                     | <b>\$ 0.31</b>   | <b>\$ 0.93</b>                    | <b>\$ 0.93</b>    |
| <b>Weighted-average number of common shares outstanding</b>                  |                                    |                  |                                   |                   |
|  | 97,157                             | 95,873           | 96,674                            | 95,365            |
| Dilutive effect of share-based compensation                                  | 361                                | 227              | 423                               | 306               |
| <b>Adjusted weighted-average shares</b>                                      | <b>97,518</b>                      | <b>96,100</b>    | <b>97,097</b>                     | <b>95,671</b>     |

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



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Hawaiian Electric Industries, Inc. and Subsidiaries

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

|   |           |           |            |            |
|---|-----------|-----------|------------|------------|
| Net income for common stock   | \$ 47,706 | \$ 48,404 | \$ 124,822 | \$ 104,005 |
| Other comprehensive income (loss), net of taxes:  |           |           |            |            |
| Net unrealized gains on securities:   |           |           |            |            |
| Net unrealized gains on securities arising during the period, net of taxes of \$689 and \$1,917 for the three months ended September 30, 2012 and 2011 and \$1,261 and \$4,258 for the nine months ended September 30, 2012 and 2011, respectively  | 1,043     | 3,013     | 1,910      | 6,448      |
| Less: reclassification adjustment for net realized gains included in net income, net of taxes of nil and \$146 for the three months ended September 30, 2012 and 2011 and \$53 and \$148 for the nine months ended September 30, 2012 and 2011, respectively  |           | (221)     | (81)       | (224)      |
| Derivatives qualified as cash flow hedges:  |           |           |            |            |
| Net unrealized holding losses arising during the period, net of taxes (benefits) of \$5 and \$(4) for the three and nine months ended September 30, 2011, respectively  |           | (5)       |            | (8)        |
| Less: reclassification adjustment to net income, net of tax benefits of \$37 and \$37 for the three months ended September 30, 2012 and 2011 and \$112 and \$78 for the nine months ended September 30, 2012 and 2011, respectively   | 59        | 58        | 177        | 122        |
| Retirement benefit plans:   |           |           |            |            |
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of tax benefits of \$2,443 and \$1,405 for the three months ended September 30, 2012 and 2011 and \$7,321 and \$3,513 for the nine months ended September 30, 2012 and 2011, respectively | 3,826     | 2,068     | 11,467     | 5,556      |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory assets, net of taxes of \$2,129 and \$1,074 for the three months ended September 30, 2012 and 2011 and \$6,386 and \$3,875 for the nine months ended September 30, 2012 and 2011, respectively                             | (3,342)   | (1,732)   | (10,026)   | (6,084)    |
| Other comprehensive income, net of taxes  | 1,586     | 3,181     | 3,447      | 5,810      |
| Comprehensive income attributable to common shareholders  | \$ 49,292 | \$ 51,585 | \$ 128,269 | \$ 109,815 |

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



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Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Balance Sheets (unaudited)****Assets**

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Cash and cash equivalents   | \$ | 168,512   | \$ | 270,265   |
| Accounts receivable and unbilled revenues, net  |    | 374,932   |    | 344,322   |
| Available-for-sale investment and mortgage-related securities   |    | 664,051   |    | 624,331   |
| Investment in stock of Federal Home Loan Bank of Seattle  |    | 96,893    |    | 97,764    |
| Loans receivable held for investment, net   |    | 3,705,748 |    | 3,642,818 |
| Loans held for sale, at lower of cost or fair value   |    | 16,495    |    | 9,601     |
| Property, plant and equipment, net of accumulated depreciation of \$2,109,478 in 2012 and \$2,049,821 in 2011 |    | 3,506,489 |    | 3,334,501 |
| Regulatory assets   |    | 715,994   |    | 669,389   |
| Other   |    | 573,523   |    | 519,296   |
| Goodwill  |    | 82,190    |    | 82,190    |
| <b>Total assets</b>   | \$ | 9,904,827 | \$ | 9,594,477 |

**Liabilities and shareholders' equity****Liabilities**

|   |    |           |    |           |
|---|----|-----------|----|-----------|
| Accounts payable                        | \$ | 234,304   | \$ | 216,176   |
| Interest and dividends payable          |    | 27,907    |    | 25,041    |
| Deposit liabilities                     |    | 4,126,788 |    | 4,070,032 |
| Short-term borrowings - other than bank |    | 82,219    |    | 68,821    |
| Other bank borrowings                   |    | 211,219   |    | 233,229   |
| Long-term debt, net - other than bank   |    | 1,429,869 |    | 1,340,070 |
| Deferred income taxes                   |    | 438,886   |    | 354,051   |
| Regulatory liabilities                  |    | 319,330   |    | 315,466   |
| Contributions in aid of construction    |    | 387,863   |    | 356,203   |
| Retirement benefits liability           |    | 497,388   |    | 530,410   |
| Other                                   |    | 507,626   |    | 521,979   |
| <b>Total liabilities</b>                |    | 8,263,399 |    | 8,031,478 |

|   |  |        |  |        |
|---|--|--------|--|--------|
| Preferred stock of subsidiaries - not subject to mandatory redemption |  | 34,293 |  | 34,293 |
|---|--|--------|--|--------|

**Commitments and contingencies (Notes 3 and 4)****Shareholders' equity**

|  |    |           |    |           |
|--|----|-----------|----|-----------|
| Preferred stock, no par value, authorized 10,000,000 shares; issued: none  |    |           |    |           |
| Common stock, no par value, authorized 200,000,000 shares; issued and outstanding: 97,425,467 shares in 2012 and 96,038,328 shares in 2011 |    | 1,389,607 |    | 1,349,446 |
| Retained earnings  |    | 233,218   |    | 198,397   |
| Accumulated other comprehensive loss, net of tax benefits  |    | (15,690)  |    | (19,137)  |
| <b>Total shareholders' equity</b>  |    | 1,607,135 |    | 1,528,706 |
| <b>Total liabilities and shareholders' equity</b>  | \$ | 9,904,827 | \$ | 9,594,477 |

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



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Hawaiian Electric Industries, Inc. and Subsidiaries

**Consolidated Statements of Changes in Shareholders Equity (unaudited)**

| (in thousands, except per share amounts)              | Common stock<br>Shares | Common stock<br>Amount | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>loss | Total               |
|---|------------------------|------------------------|----------------------|---|---------------------|
| <b>Balance, December 31, 2011</b>                     | <b>96,038</b>          | <b>\$ 1,349,446</b>    | <b>\$ 198,397</b>    | <b>\$ (19,137)</b>                            | <b>\$ 1,528,706</b> |
| Net income for common stock                           |                        |                        | 124,822              |   | 124,822             |
| Other comprehensive income, net of tax benefits       |                        |                        |                      | 3,447   | 3,447               |
| Issuance of common stock, net                         | 1,387                  | 40,161                 |                      |   | 40,161              |
| Dividend equivalents paid on equity-classified awards |                        |                        | (99)                 |   | (99)                |
| Common stock dividends (\$0.93 per share)             |                        |                        | (89,902)             |   | (89,902)            |
| <b>Balance, September 30, 2012</b>                    | <b>97,425</b>          | <b>\$ 1,389,607</b>    | <b>\$ 233,218</b>    | <b>\$ (15,690)</b>                            | <b>\$ 1,607,135</b> |
| <b>Balance, December 31, 2010</b>                     | <b>94,691</b>          | <b>\$ 1,314,199</b>    | <b>\$ 178,667</b>    | <b>\$ (12,472)</b>                            | <b>\$ 1,480,394</b> |
| Net income for common stock                           |                        |                        | 104,005              |   | 104,005             |
| Other comprehensive income, net of taxes              |                        |                        |                      | 5,810   | 5,810               |
| Issuance of common stock, net                         | 1,284                  | 33,056                 |                      |   | 33,056              |
| Common stock dividends (\$0.93 per share)             |                        |                        | (88,750)             |   | (88,750)            |
| <b>Balance, September 30, 2011</b>                    | <b>95,975</b>          | <b>\$ 1,347,255</b>    | <b>\$ 193,922</b>    | <b>\$ (6,662)</b>                             | <b>\$ 1,534,515</b> |

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

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Hawaiian Electric Industries, Inc. and Subsidiaries

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

| Nine months ended September 30<br>(in thousands)                                       | 2012              | 2011              |
|--|-------------------|-------------------|
| <b>Cash flows from operating activities</b>  |                   |                   |
| Net income   | \$ 126,239        | \$ 105,422        |
| Adjustments to reconcile net income to net cash provided by operating activities       |                   |                   |
| Depreciation of property, plant and equipment  | 112,946           | 111,516           |
| Other amortization   | 4,811             | 14,552            |
| Provision for loan losses  | 9,504             | 10,927            |
| Loans receivable originated and purchased, held for sale                               | (304,289)         | (137,507)         |
| Proceeds from sale of loans receivable, held for sale                                  | 302,844           | 127,163           |
| Change in deferred income taxes  | 82,582            | 60,957            |
| Change in excess tax benefits from share-based payment arrangements                    | (65)              | (39)              |
| Allowance for equity funds used during construction                                    | (5,548)           | (4,131)           |
| Change in cash overdraft   |                   | (2,688)           |
| Changes in assets and liabilities  |                   |                   |
| Increase in accounts receivable and unbilled revenues, net                             | (30,610)          | (75,905)          |
| Increase in fuel oil stock   | (31,372)          | (4,592)           |
| Decrease in accounts, interest and dividends payable                                   | (5,905)           | (57,746)          |
| Change in prepaid and accrued income taxes and utility revenue taxes                   | (5,121)           | 40,418            |
| Contributions to defined benefit pension and other postretirement benefit plans        | (64,006)          | (56,395)          |
| Change in other assets and liabilities   | (70,406)          | (30,863)          |
| <b>Net cash provided by operating activities</b>                                       | <b>121,604</b>    | <b>101,089</b>    |
| <b>Cash flows from investing activities</b>  |                   |                   |
| Available-for-sale investment and mortgage-related securities purchased                | (146,794)         | (202,061)         |
| Principal repayments on available-for-sale investment and mortgage-related securities  | 104,310           | 283,931           |
| Proceeds from sale of available-for-sale investment and mortgage-related securities    | 3,548             | 32,799            |
| Net increase in loans held for investment  | (75,982)          | (153,745)         |
| Proceeds from sale of real estate acquired in settlement of loans                      | 9,659             | 5,298             |
| Capital expenditures   | (225,961)         | (148,107)         |
| Contributions in aid of construction   | 33,106            | 15,106            |
| Other  | 865               | (2,923)           |
| <b>Net cash used in investing activities</b>   | <b>(297,249)</b>  | <b>(169,702)</b>  |
| <b>Cash flows from financing activities</b>  |                   |                   |
| Net increase in deposit liabilities  | 56,756            | 87,429            |
| Net increase in short-term borrowings with original maturities of three months or less | 13,398            | 26,272            |
| Net increase (decrease) in retail repurchase agreements                                | (22,011)          | 614               |
| Proceeds from issuance of long-term debt   | 457,000           | 125,000           |
| Repayment of long-term debt  | (368,500)         | (150,000)         |
| Change in excess tax benefits from share-based payment arrangements                    | 65                | 39                |
| Net proceeds from issuance of common stock   | 16,881            | 14,861            |
| Common stock dividends   | (71,966)          | (77,070)          |
| Preferred stock dividends of subsidiaries  | (1,417)           | (1,417)           |
| Other  | (6,314)           | (4,283)           |
| <b>Net cash provided by financing activities</b>                                       | <b>73,892</b>     | <b>21,445</b>     |
| Net decrease in cash and cash equivalents  | (101,753)         | (47,168)          |
| Cash and cash equivalents, beginning of period   | 270,265           | 330,651           |
| <b>Cash and cash equivalents, end of period</b>  | <b>\$ 168,512</b> | <b>\$ 283,483</b> |

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

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Hawaiian Electric Industries, Inc. and Subsidiaries

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1 • Basis of presentation**

The accompanying unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) for interim financial information, the instructions to SEC Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the balance sheet and the reported amounts of revenues and expenses for the period. Actual results could differ significantly from those estimates. The accompanying unaudited consolidated financial statements and the following notes should be read in conjunction with the audited consolidated financial statements and the notes thereto in HEI's Form 10-K for the year ended December 31, 2011 and the unaudited consolidated financial statements and the notes thereto in HEI's Quarterly Reports on SEC Form 10-Q for the quarters ended March 31, 2012 and June 30, 2012.

In the opinion of HEI's management, the accompanying unaudited consolidated financial statements contain all material adjustments required by GAAP to fairly state the Company's financial position as of September 30, 2012 and December 31, 2011, the results of its operations for the three and nine months ended September 30, 2012 and 2011 and cash flows for the nine months ended September 30, 2012 and 2011. 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. The December 31, 2011 balance sheet information has been derived from the HEI 2011 financial statements. When required, certain reclassifications are made to the prior period's consolidated financial statements to conform to the current presentation.

The Company has revised its electric utilities' previously issued financial statements to correct an error that resulted in the understatement of franchise taxes, net of tax benefits, that should have been recorded in years prior to 2010. The Company determined the cumulative impact for periods prior to 2010 to be a charge to its earnings of \$3.2 million. These adjustments were not considered to be material individually or in the aggregate to previously issued financial statements. The table below illustrates the effects of this revision on the Company's Consolidated Financial Statements for those line items affected (these revisions have no impact on the Company's Consolidated Statements of Income and Cash Flows for the periods reported):

| (in thousands)                    | As previously filed | As revised | Difference |
|-----------------------------------|---------------------|------------|------------|
| <b><u>December 31, 2011</u></b>   |                     |            |            |
| <b>Consolidated Balance Sheet</b> |                     |            |            |
| Other assets                      | \$ 517,550          | \$ 519,296 | \$ 1,746   |
| Total assets                      | 9,592,731           | 9,594,477  | 1,746      |
| Other liabilities                 | 516,990             | 521,979    | 4,989      |
| Total liabilities                 | 8,026,489           | 8,031,478  | 4,989      |
| Retained earnings                 | 201,640             | 198,397    | (3,243)    |
| Total shareholders' equity        | 1,531,949           | 1,528,706  | (3,243)    |

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|  |           |           |       |
|--|-----------|-----------|-------|
| Total liabilities and shareholders' equity | 9,592,731 | 9,594,477 | 1,746 |
|--|-----------|-----------|-------|

**Consolidated Statement of Changes in Shareholders' Equity**

|                            |           |           |         |
|----------------------------|-----------|-----------|---------|
| Retained earnings          | 201,640   | 198,397   | (3,243) |
| Total shareholders' equity | 1,531,949 | 1,528,706 | (3,243) |

**December 31, 2010**

**Consolidated Statement of Changes in Shareholders' Equity**

|                            |           |           |         |
|----------------------------|-----------|-----------|---------|
| Retained earnings          | 181,910   | 178,667   | (3,243) |
| Total shareholders' equity | 1,483,637 | 1,480,394 | (3,243) |

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**2 • Segment financial information**

| (in thousands)                               | Electric utility | Bank      | Other    | Total      |
|--|------------------|-----------|----------|------------|
| <b>Three months ended September 30, 2012</b> |                  |           |          |            |
| Revenues from external customers             | \$ 801,089       | \$ 66,596 | \$ 35    | \$ 867,720 |
| Intersegment revenues (eliminations)         | 6                |           | (6)      |            |
| Revenues                                     | 801,095          | 66,596    | 29       | 867,720    |
| Income (loss) before income taxes            | 61,268           | 21,627    | (8,914)  | 73,981     |
| Income taxes (benefit)                       | 22,395           | 7,419     | (4,010)  | 25,804     |
| Net income (loss)                            | 38,873           | 14,208    | (4,904)  | 48,177     |
| Preferred stock dividends of subsidiaries    | 498              |           | (27)     | 471        |
| Net income (loss) for common stock           | 38,375           | 14,208    | (4,877)  | 47,706     |
| <b>Nine months ended September 30, 2012</b>  |                  |           |          |            |
| Revenues from external customers             | 2,340,202        | 196,569   | 77       | 2,536,848  |
| Intersegment revenues (eliminations)         | 55               |           | (55)     |            |
| Revenues                                     | 2,340,257        | 196,569   | 22       | 2,536,848  |
| Income (loss) before income taxes            | 154,976          | 66,964    | (25,775) | 196,165    |
| Income taxes (benefit)                       | 58,429           | 22,690    | (11,193) | 69,926     |
| Net income (loss)                            | 96,547           | 44,274    | (14,582) | 126,239    |
| Preferred stock dividends of subsidiaries    | 1,496            |           | (79)     | 1,417      |
| Net income (loss) for common stock           | 95,051           | 44,274    | (14,503) | 124,822    |
| Assets (at September 30, 2012)               | 4,961,715        | 4,952,850 | (9,738)  | 9,904,827  |
| <b>Three months ended September 30, 2011</b> |                  |           |          |            |
| Revenues from external customers             | \$ 820,218       | \$ 66,100 | \$ 37    | \$ 886,355 |
| Intersegment revenues (eliminations)         | 36               |           | (36)     |            |
| Revenues                                     | 820,254          | 66,100    | 1        | 886,355    |
| Income (loss) before income taxes            | 62,244           | 23,166    | (8,641)  | 76,769     |
| Income taxes (benefit)                       | 23,787           | 7,709     | (3,602)  | 27,894     |
| Net income (loss)                            | 38,457           | 15,457    | (5,039)  | 48,875     |
| Preferred stock dividends of subsidiaries    | 498              |           | (27)     | 471        |
| Net income (loss) for common stock           | 37,959           | 15,457    | (5,012)  | 48,404     |
| <b>Nine months ended September 30, 2011</b>  |                  |           |          |            |
| Revenues from external customers             | 2,194,219        | 197,731   | (643)    | 2,391,307  |
| Intersegment revenues (eliminations)         | 108              |           | (108)    |            |
| Revenues                                     | 2,194,327        | 197,731   | (751)    | 2,391,307  |
| Income (loss) before income taxes            | 122,114          | 68,699    | (27,691) | 163,122    |
| Income taxes (benefit)                       | 46,446           | 24,196    | (12,942) | 57,700     |
| Net income (loss)                            | 75,668           | 44,503    | (14,749) | 105,422    |
| Preferred stock dividends of subsidiaries    | 1,496            |           | (79)     | 1,417      |
| Net income (loss) for common stock           | 74,172           | 44,503    | (14,670) | 104,005    |
| Assets (at December 31, 2011)                | 4,674,007        | 4,909,974 | 10,496   | 9,594,477  |

Intercompany electricity sales of the electric utilities 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 for common stock.



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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 for common stock.

### **3 • Electric utility subsidiary**

For consolidated HECO financial information, including its commitments and contingencies, see HECO's consolidated financial statements beginning on page 26 through Note 9 on page 41.

Table of Contents**4 • Bank subsidiary****Selected financial information**

American Savings Bank, F.S.B.

**Statements of Income Data**

| (in thousands)   | Three months ended<br>September 30 |                  | Nine months ended<br>September 30 |                  |
|--|------------------------------------|------------------|-----------------------------------|------------------|
|  | 2012                               | 2011             | 2012                              | 2011             |
| <b>Interest income</b>                                     |                                    |                  |                                   |                  |
| Interest and fees on loans                                 | \$ 43,880                          | \$ 46,240        | \$ 133,241                        | \$ 137,985       |
| Interest on investment and mortgage-related securities     | 3,432                              | 3,654            | 10,534                            | 11,216           |
| Total interest income                                      | 47,312                             | 49,894           | 143,775                           | 149,201          |
| <b>Interest expense</b>                                    |                                    |                  |                                   |                  |
| Interest on deposit liabilities                            | 1,540                              | 2,166            | 5,015                             | 7,146            |
| Interest on other borrowings                               | 1,201                              | 1,375            | 3,676                             | 4,124            |
| Total interest expense                                     | 2,741                              | 3,541            | 8,691                             | 11,270           |
| <b>Net interest income</b>                                 | <b>44,571</b>                      | <b>46,353</b>    | <b>135,084</b>                    | <b>137,931</b>   |
| Provision for loan losses                                  | 3,580                              | 3,822            | 9,504                             | 10,927           |
| <b>Net interest income after provision for loan losses</b> | <b>40,991</b>                      | <b>42,531</b>    | <b>125,580</b>                    | <b>127,004</b>   |
| <b>Noninterest income</b>                                  |                                    |                  |                                   |                  |
| Fees from other financial services                         | 7,674                              | 7,219            | 22,474                            | 21,405           |
| Fee income on deposit liabilities                          | 4,527                              | 4,492            | 13,127                            | 13,540           |
| Fee income on other financial products                     | 1,660                              | 1,806            | 4,741                             | 5,340            |
| Gain on sale of loans                                      | 4,077                              | 1,092            | 8,297                             | 2,268            |
| Other income   | 1,346                              | 1,597            | 4,155                             | 5,977            |
| Total noninterest income                                   | 19,284                             | 16,206           | 52,794                            | 48,530           |
| <b>Noninterest expense</b>                                 |                                    |                  |                                   |                  |
| Compensation and employee benefits                         | 18,684                             | 17,646           | 56,026                            | 53,317           |
| Occupancy  | 4,400                              | 4,313            | 12,866                            | 12,841           |
| Data processing  | 2,644                              | 2,451            | 7,244                             | 6,479            |
| Services   | 3,062                              | 1,686            | 7,066                             | 5,406            |
| Equipment  | 1,762                              | 1,712            | 5,299                             | 5,141            |
| Other expense  | 8,096                              | 7,763            | 22,909                            | 23,651           |
| Total noninterest expense                                  | 38,648                             | 35,571           | 111,410                           | 106,835          |
| <b>Income before income taxes</b>                          | <b>21,627</b>                      | <b>23,166</b>    | <b>66,964</b>                     | <b>68,699</b>    |
| Income taxes   | 7,419                              | 7,709            | 22,690                            | 24,196           |
| <b>Net income</b>  | <b>\$ 14,208</b>                   | <b>\$ 15,457</b> | <b>\$ 44,274</b>                  | <b>\$ 44,503</b> |

American Savings Bank, F.S.B.

**Statements of Comprehensive Income Data**Three months  
ended September 30Nine months  
ended September 30

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| (in thousands)  | 2012      | 2011      | 2012      | 2011      |
|---|-----------|-----------|-----------|-----------|
| Net income  | \$ 14,208 | \$ 15,457 | \$ 44,274 | \$ 44,503 |
| Other comprehensive income (loss), net of taxes:  |           |           |           |           |
| Net unrealized gains on securities:   |           |           |           |           |
| Net unrealized gains on securities arising during the period, net of taxes of \$689 and \$1,917 for the three months ended September 30, 2012 and 2011 and \$1,261 and \$4,258 for the nine months ended September 30, 2012 and 2011, respectively  | 1,043     | 3,013     | 1,910     | 6,448     |
| Less: reclassification adjustment for net realized gains, included in net income, net of taxes of nil and \$146 for the three months ended September 30, 2012 and 2011 and \$53 and \$148 for the nine months ended September 30, 2012 and 2011, respectively   |           | (221)     | (81)      | (224)     |
| Retirement benefit plans:   |           |           |           |           |
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of taxes (tax benefits) of \$(176) and \$(175) for the three months ended September 30, 2012 and 2011 and \$(508) and \$902 for the nine months ended September 30, 2012 and 2011, respectively | 266       | 86        | 769       | (1,367)   |
| Other comprehensive income, net of taxes  | 1,309     | 2,878     | 2,598     | 4,857     |
| Comprehensive income  | \$ 15,517 | \$ 18,335 | \$ 46,872 | \$ 49,360 |

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American Savings Bank, F.S.B.

**Balance Sheets Data**

| (in thousands)  | September 30,<br>2012 | December 31,<br>2011 |
|---|-----------------------|----------------------|
| <b>Assets</b>   |                       |                      |
| Cash and cash equivalents                                     | \$ 152,474            | \$ 219,678           |
| Available-for-sale investment and mortgage-related securities | 664,051               | 624,331              |
| Investment in stock of Federal Home Loan Bank of Seattle      | 96,893                | 97,764               |
| Loans receivable held for investment                          | 3,745,558             | 3,680,724            |
| Allowance for loan losses                                     | (39,810)              | (37,906)             |
| Loans receivable held for investment, net                     | 3,705,748             | 3,642,818            |
| Loans held for sale, at lower of cost or fair value           | 16,495                | 9,601                |
| Other   | 234,999               | 233,592              |
| Goodwill  | 82,190                | 82,190               |
| <b>Total assets</b>   | <b>\$ 4,952,850</b>   | <b>\$ 4,909,974</b>  |
| <b>Liabilities and shareholder s equity</b>                   |                       |                      |
| Deposit liabilities noninterest-bearing                       | \$ 1,097,809          | \$ 993,828           |
| Deposit liabilities interest-bearing                          | 3,028,979             | 3,076,204            |
| Other borrowings  | 211,219               | 233,229              |
| Other   | 107,960               | 118,078              |
| <b>Total liabilities</b>                                      | <b>4,445,967</b>      | <b>4,421,339</b>     |
| <b>Commitments and contingencies (see Litigation below)</b>   |                       |                      |
| Common stock  | 333,256               | 331,880              |
| Retained earnings   | 180,400               | 166,126              |
| Accumulated other comprehensive loss, net of tax benefits     | (6,773)               | (9,371)              |
| <b>Total shareholder s equity</b>                             | <b>506,883</b>        | <b>488,635</b>       |
| <b>Total liabilities and shareholder s equity</b>             | <b>\$ 4,952,850</b>   | <b>\$ 4,909,974</b>  |
| <b>Other assets</b>   |                       |                      |
| Bank-owned life insurance                                     | \$ 124,672            | \$ 121,470           |
| Premises and equipment, net                                   | 53,451                | 52,940               |
| Prepaid expenses  | 14,732                | 15,297               |
| Accrued interest receivable                                   | 14,205                | 14,190               |
| Mortgage-servicing rights                                     | 9,658                 | 8,227                |
| Real estate acquired in settlement of loans, net              | 4,414                 | 7,260                |
| Other   | 13,867                | 14,208               |
|   | \$ 234,999            | \$ 233,592           |
| <b>Other liabilities</b>                                      |                       |                      |
| Accrued expenses  | \$ 19,981             | \$ 21,216            |
| Federal and state income taxes payable                        | 36,308                | 35,002               |
| Cashier s checks  | 20,575                | 22,802               |
| Advance payments by borrowers                                 | 5,958                 | 10,100               |
| Other   | 25,138                | 28,958               |
|   | \$ 107,960            | \$ 118,078           |

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Other borrowings consisted of securities sold under agreements to repurchase and advances from the Federal Home Loan Bank (FHLB) of Seattle of \$161 million and \$50 million, respectively, as of September 30, 2012 and \$183 million and \$50 million, respectively, as of December 31, 2011.

Bank-owned life insurance is life insurance purchased by ASB on the lives of certain key employees, with ASB as the beneficiary. The insurance is used to fund employee benefits through tax-free income from increases in the cash value of the policies and insurance proceeds paid to ASB upon an insured's death.

As of September 30, 2012, ASB had total commitments to borrowers for loan commitments and unused lines and letters of credit of \$1.5 billion, including \$0.2 million to lend additional funds to borrowers whose loans are impaired.

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There are no commitments to lend additional funds to borrowers whose loan terms have been modified in trouble debt restructurings (TDRs) as of September 30, 2012.

**Investment and mortgage-related securities portfolio.**

Available-for-sale securities. The book value (amortized cost), gross unrealized gains and losses, estimated fair value and gross unrealized losses (fair value and amount by duration of time in which positions have been held in a continuous loss position) for securities held in ASB's available-for-sale portfolio by major security type were as follows:

| (dollars in thousands)                                  | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value | Gross unrealized losses        |          |                                |        |
|---|----------------|------------------------|-------------------------|----------------------|--------------------------------|----------|--------------------------------|--------|
|   |                |                        |                         |                      | Less than 12 months Fair value | Amount   | 12 months or longer Fair value | Amount |
| <u>September 30, 2012</u>                               |                |                        |                         |                      |                                |          |                                |        |
| Federal agency obligations                              | \$ 213,241     | \$ 3,342               | \$                      | \$ 216,583           | \$                             | \$       | \$                             | \$     |
| Mortgage-related securities-<br>FNMA, FHLMC and<br>GNMA | 353,095        | 11,706                 | (181)                   | 364,620              | 36,225                         | (181)    |                                |        |
| Municipal bonds   | 78,265         | 4,583                  |                         | 82,848               |                                |          |                                |        |
|   | \$ 644,601     | \$ 19,631              | \$ (181)                | \$ 664,051           | \$ 36,225                      | \$ (181) | \$                             | \$     |
| <u>December 31, 2011</u>                                |                |                        |                         |                      |                                |          |                                |        |
| Federal agency obligations                              | \$ 218,342     | \$ 2,393               | \$ (8)                  | \$ 220,727           | \$ 19,992                      | \$ (8)   | \$                             | \$     |
| Mortgage-related securities-<br>FNMA, FHLMC and<br>GNMA | 334,183        | 10,699                 | (17)                    | 344,865              | 11,994                         | (17)     |                                |        |
| Municipal bonds   | 55,393         | 3,346                  |                         | 58,739               |                                |          |                                |        |
|   | \$ 607,918     | \$ 16,438              | \$ (25)                 | \$ 624,331           | \$ 31,986                      | \$ (25)  | \$                             | \$     |

The unrealized losses on ASB's investments in mortgage-related securities and obligations issued by federal agencies were caused by interest rate movements. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because ASB does not intend to sell the securities and has determined it is more likely than not that it will not be required to sell the investments before recovery of their amortized costs bases, which may be at maturity, ASB did not consider these investments to be other-than-temporarily impaired at September 30, 2012.

The fair values of ASB's investment securities could decline if interest rates rise or spreads widen.

The following table details the contractual maturities of available-for-sale securities. All positions with variable maturities (e.g. callable debentures and mortgage-related securities) are disclosed based upon the bond's contractual maturity. Actual maturities will likely differ from these contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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| September 30, 2012<br>(in thousands)            | Amortized cost | Fair value |
|---|----------------|------------|
| Due in one year or less                         | \$             | \$         |
| Due after one year through five years           | 190,140        | 192,438    |
| Due after five years through ten years          | 85,682         | 90,597     |
| Due after ten years                             | 15,684         | 16,396     |
|   | 291,506        | 299,431    |
| Mortgage-related securities-FNMA,FHLMC and GNMA | 353,095        | 364,620    |
| Total available-for-sale securities             | \$ 644,601     | \$ 664,051 |

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**Allowance for loan losses.** ASB must maintain an allowance for loan losses that is adequate to absorb estimated probable credit losses associated with its loan portfolio. The allowance for loan losses consists of an allocated portion, which estimates credit losses for specifically identified loans and pools of loans, and an unallocated portion.

The allowance for loan losses was comprised of the following:

| (in thousands)                        | Residential<br>1-4 family | Commercial<br>real<br>estate | Home<br>equity line<br>of credit | Residential<br>land | Commercial<br>construction | Residential<br>construction | Commercial<br>loans | Consumer<br>loans | Unallocated | Total        |
|---------------------------------------|---------------------------|------------------------------|----------------------------------|---------------------|----------------------------|-----------------------------|---------------------|-------------------|-------------|--------------|
| <b><u>Nine months ended</u></b>       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| <b><u>September 30, 2012</u></b>      |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| <b>Allowance for loan losses:</b>     |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| Beginning balance                     | \$ 6,500                  | \$ 1,688                     | \$ 4,354                         | \$ 3,795            | \$ 1,888                   | \$ 4                        | \$ 14,867           | \$ 3,806          | \$ 1,004    | \$ 37,906    |
| Charge-offs                           | (2,476)                   |                              | (402)                            | (2,340)             |                            |                             | (2,964)             | (1,853)           |             | (10,035)     |
| Recoveries                            | 974                       |                              | 95                               | 471                 |                            |                             | 511                 | 384               |             | 2,435        |
| Provision                             | 1,729                     | 394                          | 818                              | 1,871               | 43                         | 4                           | 1,916               | 1,472             | 1,257       | 9,504        |
| Ending balance                        | \$ 6,727                  | \$ 2,082                     | \$ 4,865                         | \$ 3,797            | \$ 1,931                   | \$ 8                        | \$ 14,330           | \$ 3,809          | \$ 2,261    | \$ 39,810    |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| individually evaluated for impairment | \$ 324                    | \$ 7                         | \$ 313                           | \$ 2,321            | \$                         | \$                          | \$ 1,656            | \$                | \$          | \$ 4,621     |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| collectively evaluated for impairment | \$ 6,403                  | \$ 2,075                     | \$ 4,552                         | \$ 1,476            | \$ 1,931                   | \$ 8                        | \$ 12,674           | \$ 3,809          | \$ 2,261    | \$ 35,189    |
| <b>Financing Receivables:</b>         |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| Ending balance                        | \$ 1,899,580              | \$ 367,765                   | \$ 604,279                       | \$ 29,280           | \$ 42,913                  | \$ 5,648                    | \$ 704,100          | \$ 104,338        | \$          | \$ 3,757,903 |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| individually evaluated for impairment | \$ 26,912                 | \$ 2,929                     | \$ 1,913                         | \$ 25,146           | \$                         | \$                          | \$ 17,956           | \$ 22             | \$          | \$ 74,878    |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| collectively evaluated for impairment | \$ 1,872,668              | \$ 364,836                   | \$ 602,366                       | \$ 4,134            | \$ 42,913                  | \$ 5,648                    | \$ 686,144          | \$ 104,316        | \$          | \$ 3,683,025 |
| <b><u>Year ended</u></b>              |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| <b><u>December 31, 2011</u></b>       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| <b>Allowance for loan losses:</b>     |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| Beginning balance                     | \$ 6,497                  | \$ 1,474                     | \$ 4,269                         | \$ 6,411            | \$ 1,714                   | \$ 7                        | \$ 16,015           | \$ 3,325          | \$ 934      | \$ 40,646    |
| Charge-offs                           | (5,528)                   |                              | (1,439)                          | (4,071)             |                            |                             | (5,335)             | (3,117)           |             | (19,490)     |
| Recoveries                            | 110                       |                              | 25                               | 170                 |                            |                             | 869                 | 567               |             | 1,741        |
| Provision                             | 5,421                     | 214                          | 1,499                            | 1,285               | 174                        | (3)                         | 3,318               | 3,031             | 70          | 15,009       |
| Ending balance                        | \$ 6,500                  | \$ 1,688                     | \$ 4,354                         | \$ 3,795            | \$ 1,888                   | \$ 4                        | \$ 14,867           | \$ 3,806          | \$ 1,004    | \$ 37,906    |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| individually evaluated for impairment | \$ 203                    | \$                           | \$                               | \$ 2,525            | \$                         | \$                          | \$ 976              | \$                | \$          | \$ 3,704     |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| collectively evaluated for impairment | \$ 6,297                  | \$ 1,688                     | \$ 4,354                         | \$ 1,270            | \$ 1,888                   | \$ 4                        | \$ 13,891           | \$ 3,806          | \$ 1,004    | \$ 34,202    |
| <b>Financing Receivables:</b>         |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| Ending balance                        | \$ 1,926,774              | \$ 331,931                   | \$ 535,481                       | \$ 45,392           | \$ 41,950                  | \$ 3,327                    | \$ 716,427          | \$ 93,253         | \$          | \$ 3,694,535 |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| individually evaluated for impairment | \$ 26,012                 | \$ 13,397                    | \$ 1,450                         | \$ 39,364           | \$                         | \$                          | \$ 48,241           | \$ 24             | \$          | \$ 128,488   |
| Ending balance:                       |                           |                              |                                  |                     |                            |                             |                     |                   |             |              |
| collectively evaluated for impairment | \$ 1,900,762              | \$ 318,534                   | \$ 534,031                       | \$ 6,028            | \$ 41,950                  | \$ 3,327                    | \$ 668,186          | \$ 93,229         | \$          | \$ 3,566,047 |



Credit quality. ASB performs an internal loan review and grading on an ongoing basis. The review provides management with periodic information as to the quality of the loan portfolio and effectiveness of its lending policies and procedures. The objectives of the loan review and grading procedures are to identify, in a timely manner, existing or emerging credit trends so that appropriate steps can be initiated to manage risk and avoid or minimize future losses. Loans subject to grading include commercial and industrial, commercial real estate and commercial construction loans.

A ten-point risk rating system is used to determine loan grade and is based on borrower loan risk. The risk rating is a numerical representation of risk based on the overall assessment of the borrower's financial and operating strength including earnings, operating cash flow, debt service capacity, asset and liability structure, competitive issues, experience and quality of management, financial reporting quality and industry/economic factors.

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The loan grade categories are:

- |                             |                    |
|-----------------------------|--------------------|
| 1- Substantially risk free  | 6- Acceptable risk |
| 2- Minimal risk             | 7- Special mention |
| 3- Modest risk              | 8- Substandard     |
| 4- Better than average risk | 9- Doubtful        |
| 5- Average risk             | 10- Loss           |

Grades 1 through 6 are considered pass grades. Pass exposures generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral.

The credit risk profile by internally assigned grade for loans was as follows:

| (in thousands)  | September 30, 2012     |                         |            | December 31, 2011      |                         |            |
|-----------------|------------------------|-------------------------|------------|------------------------|-------------------------|------------|
|                 | Commercial real estate | Commercial construction | Commercial | Commercial real estate | Commercial construction | Commercial |
| Grade:          |                        |                         |            |                        |                         |            |
| Pass            | \$ 326,532             | \$ 42,913               | \$ 630,616 | \$ 308,843             | \$ 41,950               | \$ 650,234 |
| Special mention | 9,455                  |                         | 21,291     | 8,594                  |                         | 14,660     |
| Substandard     | 28,849                 |                         | 48,460     | 11,058                 |                         | 47,607     |
| Doubtful        | 2,929                  |                         | 3,733      | 3,436                  |                         | 3,926      |
| Loss            |                        |                         |            |                        |                         |            |
| Total           | \$ 367,765             | \$ 42,913               | \$ 704,100 | \$ 331,931             | \$ 41,950               | \$ 716,427 |

The credit risk profile based on payment activity for loans was as follows:

| (in thousands)             | 30-59 days past due       | 60-89 days past due | Greater than 90 days | Total past due | Current      | Total financing receivables | Recorded investment > 90 days and accruing |
|----------------------------|---------------------------|---------------------|----------------------|----------------|--------------|-----------------------------|--|
|                            | <b>September 30, 2012</b> |                     |                      |                |              |                             |  |
| Real estate loans:         |                           |                     |                      |                |              |                             |  |
| Residential 1-4 family     | \$ 5,830                  | \$ 1,727            | \$ 28,626            | \$ 36,183      | \$ 1,863,397 | \$ 1,899,580                | \$   |
| Commercial real estate     |                           |                     | 2,929                | 2,929          | 364,836      | 367,765                     |  |
| Home equity line of credit | 584                       | 758                 | 1,965                | 3,307          | 600,972      | 604,279                     |  |
| Residential land           | 1,346                     | 3,017               | 6,384                | 10,747         | 18,533       | 29,280                      | 2,473                                      |
| Commercial construction    |                           |                     |                      |                | 42,913       | 42,913                      |  |
| Residential construction   |                           |                     |                      |                | 5,648        | 5,648                       |  |
| Commercial loans           | 1,681                     | 251                 | 2,948                | 4,880          | 699,220      | 704,100                     | 123  |
| Consumer loans             | 878                       | 356                 | 491                  | 1,725          | 102,613      | 104,338                     | 360  |
| Total loans                | \$ 10,319                 | \$ 6,109            | \$ 43,343            | \$ 59,771      | \$ 3,698,132 | \$ 3,757,903                | \$ 2,956                                   |
| <b>December 31, 2011</b>   |                           |                     |                      |                |              |                             |  |
| Real estate loans:         |                           |                     |                      |                |              |                             |  |
| Residential 1-4 family     | \$ 10,391                 | \$ 4,583            | \$ 28,113            | \$ 43,087      | \$ 1,883,687 | \$ 1,926,774                | \$   |
| Commercial real estate     |                           |                     |                      |                | 331,931      | 331,931                     |  |

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|                            |           |          |           |           |              |              |        |
|----------------------------|-----------|----------|-----------|-----------|--------------|--------------|--------|
| Home equity line of credit | 1,671     | 494      | 1,421     | 3,586     | 531,895      | 535,481      |        |
| Residential land           | 2,352     | 575      | 13,037    | 15,964    | 29,428       | 45,392       | 205    |
| Commercial construction    |           |          |           |           | 41,950       | 41,950       |        |
| Residential construction   |           |          |           |           | 3,327        | 3,327        |        |
| Commercial loans           | 226       | 733      | 1,340     | 2,299     | 714,128      | 716,427      | 28     |
| Consumer loans             | 553       | 344      | 486       | 1,383     | 91,870       | 93,253       | 308    |
| Total loans                | \$ 15,193 | \$ 6,729 | \$ 44,397 | \$ 66,319 | \$ 3,628,216 | \$ 3,694,535 | \$ 541 |

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The credit risk profile based on nonaccrual loans and accruing loans 90 days or more past due was as follows:

| (in thousands)             | September 30, 2012 |   | December 31, 2011 |   |
|----------------------------|--------------------|---|-------------------|---|
|                            | Nonaccrual loans   | Accruing loans 90 days or more past due | Nonaccrual loans  | Accruing loans 90 days or more past due |
| Real estate loans:         |                    |   |                   |   |
| Residential 1-4 family     | \$ 29,613          | \$                                      | \$ 28,298         | \$                                      |
| Commercial real estate     | 2,929              |   | 3,436             |   |
| Home equity line of credit | 2,621              |   | 2,258             |   |
| Residential land           | 4,393              | 2,473                                   | 14,535            | 205                                     |
| Commercial construction    |                    |   |                   |   |
| Residential construction   |                    |   |                   |   |
| Commercial loans           | 17,856             | 123                                     | 17,946            | 28                                      |
| Consumer loans             | 243                | 360                                     | 281               | 308                                     |
| Total                      | \$ 57,655          | \$ 2,956                                | \$ 66,754         | \$ 541                                  |

The total carrying amount and the total unpaid principal balance of impaired loans were as follows:

| (in thousands)                     | September 30, 2012  |                          |                   | Three months ended September 30, 2012 |                             | Nine months ended September 30, 2012 |                             |
|------------------------------------|---------------------|--------------------------|-------------------|---------------------------------------|-----------------------------|--------------------------------------|-----------------------------|
|                                    | Recorded investment | Unpaid principal balance | Related Allowance | Average recorded investment           | Interest income recognized* | Average recorded investment          | Interest income recognized* |
| With no related allowance recorded |                     |                          |                   |                                       |                             |                                      |                             |
| Real estate loans:                 |                     |                          |                   |                                       |                             |                                      |                             |
| Residential 1-4 family             | \$ 15,963           | \$ 22,127                | \$                | \$ 15,919                             | \$ 57                       | \$ 17,104                            | \$ 225                      |
| Commercial real estate             |                     |                          |                   | 2,003                                 |                             | 9,504                                | 237                         |
| Home equity line of credit         | 584                 | 1,376                    |                   | 630                                   |                             | 648                                  | 1                           |
| Residential land                   | 18,107              | 22,854                   |                   | 19,876                                | 296                         | 24,184                               | 1,020                       |
| Commercial construction            |                     |                          |                   |                                       |                             |                                      |                             |
| Residential construction           |                     |                          |                   |                                       |                             |                                      |                             |
| Commercial loans                   | 585                 | 585                      |                   | 8,916                                 | 33                          | 31,710                               | 979                         |
| Consumer loans                     | 22                  | 22                       |                   | 23                                    |                             | 23                                   |                             |
|                                    | 35,261              | 46,964                   |                   | 47,367                                | 386                         | 83,173                               | 2,462                       |
| With an allowance recorded         |                     |                          |                   |                                       |                             |                                      |                             |
| Real estate loans:                 |                     |                          |                   |                                       |                             |                                      |                             |
| Residential 1-4 family             | 4,504               | 4,504                    | 324               | 4,509                                 | 58                          | 4,072                                | 192                         |
| Commercial real estate             | 2,929               | 2,929                    | 7                 | 976                                   |                             | 326                                  |                             |
| Home equity line of credit         | 313                 | 421                      | 313               | 104                                   |                             | 35                                   |                             |
| Residential land                   | 7,021               | 7,243                    | 2,321             | 7,134                                 | 122                         | 7,306                                | 429                         |
| Commercial construction            |                     |                          |                   |                                       |                             |                                      |                             |
| Residential construction           |                     |                          |                   |                                       |                             |                                      |                             |
| Commercial loans                   | 17,370              | 20,398                   | 1,656             | 9,476                                 | 2                           | 5,777                                | 20                          |
| Consumer loans                     |                     |                          |                   |                                       |                             |                                      |                             |
|                                    | 32,137              | 35,495                   | 4,621             | 22,199                                | 182                         | 17,516                               | 641                         |
| Total                              |                     |                          |                   |                                       |                             |                                      |                             |

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Real estate loans:

|                            |           |           |          |           |        |            |          |
|----------------------------|-----------|-----------|----------|-----------|--------|------------|----------|
| Residential 1-4 family     | 20,467    | 26,631    | 324      | 20,428    | 115    | 21,176     | 417      |
| Commercial real estate     | 2,929     | 2,929     | 7        | 2,979     |        | 9,830      | 237      |
| Home equity line of credit | 897       | 1,797     | 313      | 734       |        | 683        | 1        |
| Residential land           | 25,128    | 30,097    | 2,321    | 27,010    | 418    | 31,490     | 1,449    |
| Commercial construction    |           |           |          |           |        |            |          |
| Residential construction   |           |           |          |           |        |            |          |
| Commercial loans           | 17,955    | 20,983    | 1,656    | 18,392    | 35     | 37,487     | 999      |
| Consumer loans             | 22        | 22        |          | 23        |        | 23         |          |
|                            | \$ 67,398 | \$ 82,459 | \$ 4,621 | \$ 69,566 | \$ 568 | \$ 100,689 | \$ 3,103 |

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\* Since loan was classified as impaired.

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| (in thousands)                     | Recorded investment | December 31, 2011<br>Unpaid principal balance | Related allowance | Year ended December 31, 2011<br>Average recorded investment | Interest income recognized |
|------------------------------------|---------------------|---|-------------------|---|----------------------------|
| With no related allowance recorded |                     |   |                   |   |                            |
| Real estate loans:                 |                     |   |                   |   |                            |
| Residential 1-4 family             | \$ 19,217           | \$ 26,614                                     | \$                | \$ 21,385   | \$ 282                     |
| Commercial real estate             | 13,397              | 13,397  |                   | 13,404  | 747                        |
| Home equity line of credit         | 711                 | 1,612   |                   | 954   | 6                          |
| Residential land                   | 30,781              | 39,136  |                   | 33,398  | 1,779                      |
| Commercial construction            |                     |   |                   |   |                            |
| Residential construction           |                     |   |                   |   |                            |
| Commercial loans                   | 41,680              | 43,516  |                   | 40,952  | 2,912                      |
| Consumer loans                     | 25                  | 25  |                   | 16  |                            |
|                                    | 105,811             | 124,300                                       |                   | 110,109   | 5,726                      |
| With an allowance recorded         |                     |   |                   |   |                            |
| Real estate loans:                 |                     |   |                   |   |                            |
| Residential 1-4 family             | 3,525               | 3,525   | 203               | 3,527   | 201                        |
| Commercial real estate             |                     |   |                   |   |                            |
| Home equity line of credit         |                     |   |                   |   |                            |
| Residential land                   | 7,792               | 7,852   | 2,525             | 8,158   | 603                        |
| Commercial construction            |                     |   |                   |   |                            |
| Residential construction           |                     |   |                   |   |                            |
| Commercial loans                   | 6,561               | 6,561   | 976               | 8,131   | 737                        |
| Consumer loans                     |                     |   |                   |   |                            |
|                                    | 17,878              | 17,938  | 3,704             | 19,816  | 1,541                      |
| Total                              |                     |   |                   |   |                            |
| Real estate loans:                 |                     |   |                   |   |                            |
| Residential 1-4 family             | 22,742              | 30,139  | 203               | 24,912  | 483                        |
| Commercial real estate             | 13,397              | 13,397  |                   | 13,404  | 747                        |
| Home equity line of credit         | 711                 | 1,612   |                   | 954   | 6                          |
| Residential land                   | 38,573              | 46,988  | 2,525             | 41,556  | 2,382                      |
| Commercial construction            |                     |   |                   |   |                            |
| Residential construction           |                     |   |                   |   |                            |
| Commercial loans                   | 48,241              | 50,077  | 976               | 49,083  | 3,649                      |
| Consumer loans                     | 25                  | 25  |                   | 16  |                            |
|                                    | \$ 123,689          | \$ 142,238                                    | \$ 3,704          | \$ 129,925  | \$ 7,267                   |

**Troubled debt restructurings.** A loan modification is deemed to be a TDR when ASB grants a concession it would not otherwise consider were it not for the borrower's financial difficulty. When a borrower fails to make a required payment on a loan or is in imminent default, ASB takes a number of steps to induce the borrower to cure the delinquency and restore the loan to current status or to avoid payment default. At times, ASB may restructure a loan to help a distressed borrower improve their financial position to eventually be able to fully repay the loan, provided the borrower has demonstrated both the willingness and the ability to handle the modified terms. TDR loans are considered an alternative to foreclosure or liquidation with the goal of minimizing losses to ASB and maximizing recovery.

ASB may consider various types of concessions in granting a TDR including maturity date extensions, temporary deferral of principal payments, temporary interest rate reductions, and covenant amendments or waivers. ASB rarely grants principal forgiveness in its TDR modifications. Residential loan modifications generally involve the deferral of principal payments for a period of time not exceeding one year or a temporary reduction of principal and/or interest rate for a period of time generally not exceeding two years. Land loans are typically structured as a three-year term, interest-only monthly payment with a balloon payment due at maturity. Land loan TDR modifications typically involve extending the maturity date another one to three years and converting the payments from interest-only to principal and interest monthly, at the same or higher interest rate. Commercial loan modifications generally involve extensions of maturity dates, amendment or waiver of financial

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covenants, and to a lesser extent temporary deferral of principal payments. ASB does not reduce the interest rate on commercial loan TDR modifications. Occasionally, additional collateral and/or guaranties are obtained.

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All TDR loans are classified impaired and are segregated and reviewed separately when assessing the adequacy of the allowance for loan losses based on the appropriate method of measuring impairment: (1) present value of expected future cash flows discounted at the loan's effective original contractual rate, (2) fair value of collateral less costs to sell, or (3) observable market price. The financial impact of the calculated impairment amount is an increase to the allowance associated with the modified loan. When available information confirms that specific loans or portions thereof are uncollectible (confirmed losses), these amounts are charged off against the allowance for loan losses.

Loan modifications that occurred were as follows for the indicated periods:

| (dollars in thousands)       | Three months ended September 30, 2012 |  |   | Nine months ended September 30, 2012 |  |   |
|------------------------------|---------------------------------------|--|---|--------------------------------------|--|---|
|                              | Number of contracts                   | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment | Number of contracts                  | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment |
| Troubled debt restructurings |                                       |  |   |                                      |  |   |
| Real estate loans:           |                                       |  |   |                                      |  |   |
| Residential 1-4 family       | 4                                     | \$ 1,415   | \$ 1,332  | 26                                   | \$ 5,884   | \$ 5,614  |
| Commercial real estate       |                                       |  |   |                                      |  |   |
| Home equity line of credit   |                                       |  |   |                                      |  |   |
| Residential land             | 6                                     | 1,168  | 1,001   | 21                                   | 4,676  | 4,022   |
| Commercial loans             | 4                                     | 517  | 517   | 18                                   | 2,546  | 2,546   |
| Consumer loans               |                                       |  |   |                                      |  |   |
| Total                        | 14                                    | \$ 3,100   | \$ 2,850  | 65                                   | \$ 13,106  | \$ 12,182   |

Loans modified in TDRs that experienced a payment default of 90 days or more, and for which the payment default occurred within one year of the modification, were nil for the three months ended September 30, 2012 and were as follows for the nine months ended September 30, 2012:

| (dollars in thousands)                                   | Nine months ended September 30, 2012 |                     |
|--|--------------------------------------|---------------------|
|  | Number of contracts                  | Recorded investment |
| Troubled debt restructurings that subsequently defaulted |                                      |                     |
| Real estate loans:                                       |                                      |                     |
| Residential 1-4 family                                   |                                      | \$                  |
| Commercial real estate                                   |                                      |                     |
| Home equity line of credit                               |                                      |                     |
| Residential land   |                                      |                     |
| Commercial loans   | 1                                    | 488                 |
| Consumer loans   |                                      |                     |
| Total  | 1                                    | \$ 488              |

The one commercial loan that subsequently defaulted was modified by temporarily lowering the monthly payments and deferring principal payments for a short period of time.



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**Litigation.** In March 2011, a purported class action lawsuit was filed in the First Circuit Court of the State of Hawaii by a customer who claimed that ASB had improperly charged overdraft fees on debit card transactions. The lawsuit is still in its preliminary stage, thus, the probable outcome and range of reasonably possible loss are not determinable at this time.

ASB is subject in the normal course of business to pending and threatened legal proceedings. Management does not anticipate that the aggregate ultimate liability arising out of these pending or threatened legal proceedings will be material to its financial position. However, ASB cannot rule out the possibility that such outcomes could have a material adverse effect on the results of operations or liquidity for a particular reporting period in the future.

Table of Contents**5 • Retirement benefits**

**Defined benefit pension and other postretirement benefit plans information.** For the first nine months of 2012, the Company contributed \$64 million (\$62 million by the utilities and \$2 million by HEI) to its retirement benefit plans, compared to \$56 million (primarily by the utilities) in the first nine months of 2011. The Company's current estimate of contributions to its retirement benefit plans in 2012 is \$78 million (\$63 million by the utilities, \$13 million by ASB (for its frozen defined benefit pension plan) and \$2 million by HEI), compared to \$75 million (\$73 million by the utilities and \$2 million by HEI) in 2011. In addition, the Company expects to pay directly \$2 million (\$1 million each by the utilities and HEI) of benefits in 2012, comparable to 2011.

On July 6, 2012, President Obama signed the Moving Ahead for Progress in the 21st Century Act (MAP-21), which included provisions related to the funding and administration of pension plans. This law does not affect the Company's accounting for pension benefits; therefore, the net periodic benefit costs disclosed for the plans were not affected. The Company elected to apply MAP-21 for 2012, which reduced the 2012 minimum funding requirement and lifted the restrictions on accelerated distribution options (which restrictions were in effect April 1, 2011 to September 30, 2012) for HEI and HECO and its subsidiaries. If the Adjusted Funding Target Attainment Percentage falls below 80% in the future, the restrictions on accelerated distribution options may apply again.

The Pension Protection Act provides that if a pension plan's funded status falls below certain levels, more conservative assumptions must be used to value obligations under the pension plan. The HEI Retirement Plan fell below these thresholds in 2011 and the minimum required contribution for 2012 incorporates the more conservative assumptions required. Other factors could cause changes to the required contribution levels.

The components of net periodic benefit cost for consolidated HEI were as follows:

| (in thousands)  | Three months ended September 30 |           |                |         | Nine months ended September 30 |           |                |          |
|---|---------------------------------|-----------|----------------|---------|--------------------------------|-----------|----------------|----------|
|   | Pension benefits                |           | Other benefits |         | Pension benefits               |           | Other benefits |          |
|   | 2012                            | 2011      | 2012           | 2011    | 2012                           | 2011      | 2012           | 2011     |
| Service cost  | \$ 10,816                       | \$ 8,525  | \$ 1,054       | \$ 868  | \$ 32,404                      | \$ 26,266 | \$ 3,158       | \$ 3,308 |
| Interest cost   | 16,868                          | 16,137    | 2,252          | 2,273   | 50,612                         | 48,717    | 6,756          | 7,151    |
| Expected return on plan assets                              | (17,796)                        | (17,400)  | (2,579)        | (2,687) | (53,388)                       | (51,673)  | (7,757)        | (7,992)  |
| Amortization of net transition obligation                   | 1                               | 1         |                |         | 1                              | 2         |                |          |
| Amortization of prior service gain                          | (81)                            | (98)      | (448)          | (587)   | (244)                          | (292)     | (1,345)        | (1,120)  |
| Amortization of net actuarial loss                          | 6,425                           | 4,005     | 373            | 115     | 19,251                         | 12,724    | 1,125          | 170      |
| Net periodic benefit cost                                   | 16,233                          | 11,170    | 652            | (18)    | 48,636                         | 35,744    | 1,937          | 1,517    |
| Impact of PUC D&Os  | (3,460)                         | (713)     | (552)          | 327     | (12,294)                       | (2,813)   | (1,648)        | 3,079    |
| Net periodic benefit cost (adjusted for impact of PUC D&Os) | \$ 12,773                       | \$ 10,457 | \$ 100         | \$ 309  | \$ 36,342                      | \$ 32,931 | \$ 289         | \$ 4,596 |

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Consolidated HEI recorded retirement benefits expense of \$27 million and \$28 million in the first nine months of 2012 and 2011, respectively, and charged the remaining amounts primarily to electric utility plant.

The utilities have implemented pension and OPEB tracking mechanisms under which all of their retirement benefit expenses (except for executive life and nonqualified pension plan expenses) determined in accordance with GAAP are recovered over time.

**Defined contribution plans information.** For the first nine months of 2012 and 2011, the Company's expense for its defined contribution pension plans under the Hawaiian Electric Industries Retirement Savings Plan (HEIRSP) and the ASB 401(k) Plan was \$2.7 million and \$2.6 million, respectively, and cash contributions were \$3.2 million for both periods.

Table of Contents**6 • Share-based compensation**

Under the 2010 Equity and Incentive Plan (EIP), HEI can issue an aggregate of 4 million shares of common stock as incentive compensation to selected employees in the form of stock options, stock appreciation rights, restricted shares, restricted stock units, performance shares and other share-based and cash-based awards.

As of September 30, 2012, there were 3.8 million shares remaining available for future issuance under the EIP of which an estimated 1.7 million shares could be issued upon the vesting of outstanding restricted stock units and the achievement of performance goals under long-term incentive plans (based on the assumption that long-term incentive plan (LTIP) awards are achieved at maximum levels).

Under the 1987 Stock Option and Incentive Plan, as amended (SOIP), grants and awards of an estimated 0.5 million shares of common stock (based on various assumptions, including LTIP awards earned at maximum levels and the use of the September 30, 2012 market price of shares as the price on the exercise/payment dates) were outstanding as of September 30, 2012 to selected employees in the form of nonqualified stock options (NQSOs), stock appreciation rights (SARs), restricted stock units, LTIP performance and other shares and dividend equivalents. As of May 11, 2010 (when the EIP became effective), no new awards may be granted under the SOIP. After the shares of common stock for the outstanding SOIP grants and awards are issued or such grants and awards expire, the remaining shares registered under the SOIP will be deregistered and delisted.

The Company's share-based compensation expense and related income tax benefit were as follows:

| (in millions)                        | Three months ended<br>September 30 |        | Nine months ended<br>September 30 |        |
|--------------------------------------|------------------------------------|--------|-----------------------------------|--------|
|                                      | 2012                               | 2011   | 2012                              | 2011   |
| Share-based compensation expense (1) | \$ 1.2                             | \$ 1.0 | \$ 4.7                            | \$ 2.7 |
| Income tax benefit                   | 0.4                                | 0.4    | 1.6                               | 0.9    |

(1) The Company has not capitalized any share-based compensation cost.

**Nonqualified stock options.** Information about HEI's NQSOs was as follows:

| September 30, 2012 | Outstanding & Exercisable (Vested) |                   |   |                                 |
|--------------------|------------------------------------|-------------------|---|---------------------------------|
| Year of grant      | Range of exercise prices           | Number of options | Weighted-average remaining contractual life | Weighted-average exercise price |
| 2003               | \$ 20.49                           | 14,000            | 0.6   | \$ 20.49                        |

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As of December 31, 2011, NQSOs outstanding totaled 55,500 (representing the same number of underlying shares), with a weighted-average exercise price of \$20.92. As of September 30, 2012, all NQSOs outstanding were exercisable and had an aggregate intrinsic value (including dividend equivalents) of \$0.1 million.

NQSO activity and statistics were as follows:

| (dollars in thousands, except prices)                         | Three months ended<br>September 30 |          | Nine months ended<br>September 30 |          |
|---|------------------------------------|----------|-----------------------------------|----------|
|   | 2012                               | 2011     | 2012                              | 2011     |
| Shares exercised  | 8,000                              | 2,000    | 41,500                            | 104,000  |
| Weighted-average exercise price                               | \$ 20.49                           | \$ 20.49 | \$ 21.06                          | \$ 20.81 |
| Cash received from exercise                                   | \$ 164                             | \$ 41    | \$ 874                            | \$ 2,164 |
| Intrinsic value of shares exercised (1)                       | \$ 89                              | \$ 6     | \$ 354                            | \$ 846   |
| Tax benefit (expense) realized for the deduction of exercises | \$ 35                              | \$ (85)  | \$ 138                            | \$ 186   |

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(1) Intrinsic value is the amount by which the fair market value of the underlying stock and the related dividend equivalents exceeds the exercise price of the option.

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**Stock appreciation rights.** Information about HEI's SARs was as follows:

| Year of grant | September 30, 2012       |               | Outstanding & Exercisable (Vested) |   |                                 |
|---------------|--------------------------|---------------|------------------------------------|---|---------------------------------|
|               | Range of exercise prices |               | Number of shares underlying SARs   | Weighted-average remaining contractual life | Weighted-average exercise price |
| 2004          | \$                       | 26.02         | 62,000                             | 1.6   | \$ 26.02                        |
| 2005          |                          | 26.18         | 106,000                            | 2.4   | 26.18                           |
|               | \$                       | 26.02 - 26.18 | 168,000                            | 2.1   | \$ 26.12                        |

As of December 31, 2011, the shares underlying SARs outstanding totaled 282,000, with a weighted-average exercise price of \$26.14. As of September 30, 2012, all SARs outstanding were exercisable and had an aggregate intrinsic value (including dividend equivalent rights) of \$0.1 million.

SARs activity and statistics were as follows:

| (dollars in thousands, except prices)               | Three months ended September 30 |          | Nine months ended September 30 |          |
|---|---------------------------------|----------|--------------------------------|----------|
|   | 2012                            | 2011     | 2012                           | 2011     |
| Shares underlying SARs expired                      |                                 | 18,000   |                                | 58,000   |
| Weighted-average price of shares expired            |                                 | \$ 26.18 |                                | \$ 26.13 |
| Shares underlying SARs exercised                    | 2,000                           |          | 114,000                        |          |
| Weighted-average price of shares exercised          | \$ 26.18                        |          | \$ 26.17                       |          |
| Intrinsic value of shares exercised (1)             | \$ 3                            |          | \$ 197                         |          |
| Tax benefit realized for the deduction of exercises | \$ 1                            |          | \$ 77                          |          |

(1) Intrinsic value is the amount by which the fair market value of the underlying stock and the related dividend equivalent rights exceeds the exercise price of the right.

**Restricted shares and restricted stock awards.** Information about HEI's grants of restricted shares and restricted stock awards was as follows:

|                                  | Three months ended September 30 |          |        |          | Nine months ended September 30 |          |          |          |
|----------------------------------|---------------------------------|----------|--------|----------|--------------------------------|----------|----------|----------|
|                                  | 2012                            |          | 2011   |          | 2012                           |          | 2011     |          |
|                                  | Shares                          | (1)      | Shares | (1)      | Shares                         | (1)      | Shares   | (1)      |
| Outstanding, beginning of period | 14,807                          | \$ 22.45 | 57,909 | \$ 23.91 | 46,807                         | \$ 24.45 | 89,709   | \$ 24.64 |
| Granted                          |                                 |          |        |          |                                |          |          |          |
| Vested                           | (1,000)                         | 24.68    |        |          | (33,000)                       | 25.35    | (29,800) | 26.03    |

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|                            |        |    |       |        |    |       |        |    |       |         |    |       |
|----------------------------|--------|----|-------|--------|----|-------|--------|----|-------|---------|----|-------|
| Forfeited                  |        |    |       | (300)  |    | 24.71 |        |    |       | (2,300) |    | 24.98 |
| Outstanding, end of period | 13,807 | \$ | 22.29 | 57,609 | \$ | 23.90 | 13,807 | \$ | 22.29 | 57,609  | \$ | 23.90 |

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(1) Weighted-average grant-date fair value per share. The grant date fair value of a restricted stock award share was the closing or average price of HEI common stock on the date of grant.

As of September 30, 2012, there was \$0.2 million of total unrecognized compensation cost related to nonvested restricted shares and restricted stock awards. The cost is expected to be recognized over a weighted-average period of 2.2 years.

For each of the nine months ended September 30, 2012 and 2011, total restricted stock vested had a fair value of \$0.8 million. The tax benefits realized for tax deductions related to restricted stock awards were \$0.2 million and \$0.1 million for the first nine months of 2012 and 2011, respectively.

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**Restricted stock units.** Information about HEI's grants of restricted stock units was as follows:

|                                  | Three months ended September 30 |          |           |          | Nine months ended September 30 |          |           |          |
|----------------------------------|---------------------------------|----------|-----------|----------|--------------------------------|----------|-----------|----------|
|                                  | 2012                            |          | 2011      |          | 2012                           |          | 2011      |          |
|                                  | Shares                          | (1)      | Shares    | (1)      | Shares                         | (1)      | Shares    | (1)      |
| Outstanding, beginning of period | 319,071                         | \$ 22.81 | 231,517   | \$ 21.70 | 247,286                        | \$ 21.80 | 146,500   | \$ 19.80 |
| Granted                          |                                 |          | 10,000(3) | 22.31    | 94,846(2)                      | 26.00    | 96,017(3) | 24.69    |
| Vested                           | (2,500)                         | 22.31    |           |          | (23,997)                       | 24.69    |           |          |
| Forfeited                        | (3,346)                         | 24.63    |           |          | (4,910)                        | 24.92    | (1,000)   | 22.60    |
| Outstanding, end of period       | 313,225                         | \$ 22.80 | 241,517   | \$ 21.73 | 313,225                        | \$ 22.80 | 241,517   | \$ 21.73 |

(1) Weighted-average grant-date fair value per share. The grant date fair value of the restricted stock units was the average price of HEI common stock on the date of grant.

(2) Total weighted-average grant-date fair value of \$2.5 million.

(3) Total weighted-average grant-date fair value of \$0.2 million and \$2.4 million for three and nine months ended September 30, 2011, respectively.

As of September 30, 2012, there was \$3.9 million of total unrecognized compensation cost related to the nonvested restricted stock units. The cost is expected to be recognized over a weighted-average period of 2.7 years.

For the nine months ended September 30, 2012, total restricted stock units that vested and related dividends had a fair value of \$0.7 million and the related tax benefits were \$0.2 million.

**LTIP payable in stock.** The 2011-2013 LTIP and the 2012-2014 LTIP provide for performance awards under the EIP and the 2010-2012 LTIP provides for performance awards under the SOIP of shares of HEI common stock based on the satisfaction of performance goals and service conditions. The number of shares of HEI common stock that may be awarded is fixed on the date the grants are made subject to the achievement of specified performance levels. The payout varies from 0% to 200% of the number of target shares depending on achievement of the goals. The LTIP performance goals for both LTIP periods include awards with a market goal based on total return to shareholders (TRS) of HEI stock as a percentile to the Edison Electric Institute Index over the applicable three-year period. In addition, the 2010-2012 LTIP has performance goals related to levels of HEI consolidated net income, HECO consolidated return on average common equity (ROACE), ASB net income and ASB return on assets—all based on two-year averages (2011-2012), and the 2011-2013 LTIP and the 2012-2014 LTIP have performance goals related to levels of HEI consolidated net income, HECO consolidated net income, HECO consolidated ROACE, ASB net income and ASB return on assets—all based on the applicable three-year averages.

LTIP linked to TRS. Information about HEI's LTIP grants linked to TRS was as follows:



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|                                  | Three months ended September 30 |          |         |          | Nine months ended September 30 |          |           |          |
|----------------------------------|---------------------------------|----------|---------|----------|--------------------------------|----------|-----------|----------|
|                                  | 2012                            |          | 2011    |          | 2012                           |          | 2011      |          |
|                                  | Shares                          | (1)      | Shares  | (1)      | Shares                         | (1)      | Shares    | (1)      |
| Outstanding, beginning of period | 239,407                         | \$ 29.12 | 199,563 | \$ 25.99 | 197,385                        | \$ 25.94 | 126,782   | \$ 20.33 |
| Granted                          | 1,723                           | 30.71    |         |          | 80,647(2)                      | 30.71    | 75,015(3) | 35.46    |
| Vested                           |                                 |          |         |          | (35,397)                       | 14.85    |           |          |
| Forfeited                        | (2,450)                         | 31.09    | (1,063) | 30.67    | (3,955)                        | 30.82    | (3,297)   | 25.10    |
| Outstanding, end of period       | 238,680                         | \$ 29.11 | 198,500 | \$ 25.97 | 238,680                        | \$ 29.11 | 198,500   | \$ 25.97 |

- 
- (1) Weighted-average grant-date fair value per share determined using a Monte Carlo simulation model.
- (2) Total weighted-average grant-date fair value of \$2.5 million.
- (3) Total weighted-average grant-date fair value of \$2.7 million.

In the third quarter of 2012, LTIP grants (under the 2012-2014 LTIP) were made payable in 1,723 shares of HEI common stock (based on the grant date prices of \$27.35 and \$27.22 and target TRS performance levels), with a weighted-average grant date fair value of \$0.1 million based on the weighted-average grant date fair value per share of \$30.71.

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The following table summarizes the assumptions used to determine the fair value of the LTIP awards linked to TRS and the resulting fair value of LTIP awards granted:

|   | 2012           |       | 2011           |       |
|---|----------------|-------|----------------|-------|
| Risk-free interest rate                     | 0.33%          |       | 1.25%          |       |
| Expected life in years                      | 3              |       | 3              |       |
| Expected volatility                         | 25.3%          |       | 27.8%          |       |
| Range of expected volatility for Peer Group | 15.5% to 34.5% |       | 21.2% to 82.6% |       |
| Grant date fair value (per share)           | \$             | 30.71 | \$             | 35.46 |

For the nine months ended September 30, 2012, total vested LTIP awards linked to TRS and related dividends had a fair value of \$0.6 million and the related tax benefits were \$0.2 million.

As of September 30, 2012, there was \$3.0 million of total unrecognized compensation cost related to the nonvested performance awards payable in shares linked to TRS. The cost is expected to be recognized over a weighted-average period of 1.2 years.

LTIP awards linked to other performance conditions. Information about HEI's LTIP awards payable in shares linked to other performance conditions was as follows:

|                                  | Three months ended September 30 |          |         |          | Nine months ended September 30 |          |            |          |
|----------------------------------|---------------------------------|----------|---------|----------|--------------------------------|----------|------------|----------|
|                                  | 2012                            |          | 2011    |          | 2012                           |          | 2011       |          |
|                                  | Shares                          | (1)      | Shares  | (1)      | Shares                         | (1)      | Shares     | (1)      |
| Outstanding, beginning of period | 295,184                         | \$ 23.95 | 185,767 | \$ 22.63 | 182,498                        | \$ 22.63 | 161,310    | \$ 18.66 |
| Granted                          | 4,148                           | 27.30    |         |          | 122,852(2)                     | 26.05    | 113,831(3) | 24.96    |
| Vested                           |                                 |          |         |          |                                |          |            |          |
| Cancelled                        | (17,911)                        | 18.95    |         |          | (17,911)                       | 18.95    | (81,908)   | 18.38    |
| Forfeited                        | (3,676)                         | 24.78    | (1,596) | 22.74    | (9,694)                        | 24.44    | (9,062)    | 19.61    |
| Outstanding, end of period       | 277,745                         | \$ 24.31 | 184,171 | \$ 22.63 | 277,745                        | \$ 24.31 | 184,171    | \$ 22.63 |

- 
- (1) Weighted-average grant-date fair value per share based on the average price of HEI common stock on the date of grant.
  - (2) Total weighted-average grant-date fair value of \$3.2 million.
  - (3) Total weighted-average grant-date fair value of \$2.8 million.

In the third quarter of 2012, LTIP grants (under the 2012-2014 LTIP) were made payable in 4,148 shares of HEI common stock (based on the grant date prices of \$27.35 and \$27.22 and target performance levels relating to performance goals other than TRS), with a weighted-average grant date fair value of \$0.1 million based on the weighted-average grant date fair value per share of \$27.35 and \$27.22.

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As of September 30, 2012, there was \$3.5 million of total unrecognized compensation cost related to the nonvested shares linked to performance conditions other than TRS. The cost is expected to be recognized over a weighted-average period of 1.5 years.

### 7 • Earnings per share

Under the two-class method of computing earnings per share (EPS), EPS was comprised as follows for both unvested restricted stock awards and unrestricted common stock:

|                        | Three months ended September 30 |                   | Nine months ended September 30 |                   |
|------------------------|---------------------------------|-------------------|--------------------------------|-------------------|
|                        | 2012                            | 2011              | 2012                           | 2011              |
|                        | Basic and diluted               | Basic and diluted | Basic and diluted              | Basic and diluted |
| Distributed earnings   | \$ 0.31                         | \$ 0.31           | \$ 0.93                        | \$ 0.93           |
| Undistributed earnings | 0.18                            | 0.19              | 0.36                           | 0.16              |
|                        | \$ 0.49                         | \$ 0.50           | \$ 1.29                        | \$ 1.09           |

As of September 30, 2012, there were no shares that were antidilutive. As of September 30, 2011, the antidilutive effects of SARs of 392,000 shares of HEI common stock, for which the exercise prices were greater than the closing market price of HEI's common stock were not included in the computation of diluted EPS.

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**8 • Commitments and contingencies**

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

**9 • Fair value measurements**

Fair value estimates are based on the price that would be received to sell an asset, or paid upon the transfer of a liability, in an orderly transaction between market participants at the measurement date. The fair value estimates are generally determined based on assumptions that market participants would use in pricing the asset or liability and are based on market data obtained from independent sources. However, in certain cases, the Company uses its own assumptions about market participant assumptions based on the best information available in the circumstances. These valuations are estimates at a specific point in time, based on relevant market information, information about the financial instrument and judgments regarding future expected loss experience, economic conditions, risk characteristics of various financial instruments and other factors. These estimates do not reflect any premium or discount that could result if the Company were to sell its entire holdings of a particular financial instrument at one time. Because no active trading market exists for a portion of the Company's financial instruments, fair value estimates cannot be determined with precision. Changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the estimates. In addition, the tax ramifications related to the realization of the unrealized gains and losses could have a significant effect on fair value estimates, but have not been considered in making such estimates.

The Company groups its financial assets measured at fair value in three levels outlined as follows:

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company used the following methods and assumptions to estimate the fair value of each applicable class of financial instruments for which it is practicable to estimate that value:

**Cash and cash equivalents and short term borrowings other than bank.** The carrying amount approximated fair value because of the short maturity of these instruments.

**Investment and mortgage-related securities.** To determine the fair value of investment securities held in ASB's available-for-sale portfolio, independent third-party vendor or broker pricing is used on an unadjusted basis. Under this methodology, valuation is based upon quoted prices for similar assets in active markets; quoted prices for identical or similar assets in markets that are not active; or use of valuation methodologies that use inputs that are derived principally from or can be corroborated by observable market data by correlation or other means.

On a quarterly basis, fair value pricing levels obtained from ASB's third-party vendor are reviewed by comparing its prices to a separate third party pricing service or to non-binding third-party broker quotes. ASB's third-party vendor pricing is validated in the majority of cases for the determination of fair value. However, in cases where there are less active and orderly markets or less transparent information from ASB's third-party vendor, fair value may be estimated by use of prices from the separate third party pricing service or from non-binding third-party broker quotes.

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**Loans receivable.** The estimated fair value of loans receivable is determined based on characteristics such as loan category, repricing features and remaining maturity, and includes prepayment estimates.

For residential real estate loans, fair values were estimated by discounting estimated cash flows using discount rates based on current industry pricing for loans with similar contractual characteristics and remaining maturity.

For other types of loans, fair values were estimated by discounting contractual cash flows using discount rates that reflect current industry pricing for loans with similar characteristics and remaining maturity. Where industry pricing is not available, discount rates are based on ASB's current pricing for loans with similar characteristics and remaining maturity.

The fair value of all loans was adjusted to reflect current assessments of loan collectability. Also see Fair value measurements on a nonrecurring basis below.

**Deposit liabilities.** The fair value of savings, negotiable orders of withdrawal, demand and money market deposits was the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit was estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

**Other bank borrowings and long-term debt.** Fair value was estimated by discounting the future cash flows using the current rates available for borrowings with similar credit terms and remaining maturities.

**Off-balance sheet financial instruments.** The fair value of loans serviced for others was calculated by discounting expected net income streams using discount rates that reflect industry pricing for similar assets. Expected net income streams were estimated based on industry assumptions regarding prepayment speeds and income and expenses associated with servicing residential mortgage loans for others. The fair value of commitments to originate loans was estimated based on the change in current primary market prices of new commitments. Since lines of credit can expire without being drawn and customers are under no obligation to utilize the lines, no fair value was assigned to unused lines of credit. The fair value of letters of credit was estimated based on the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements.

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The estimated fair values of certain of the Company's financial instruments were as follows:

| (in thousands)  | Carrying or<br>notional<br>amount | September 30, 2012 |                      |           | Total      | December 31, 2011                 |                         |
|---|-----------------------------------|--------------------|----------------------|-----------|------------|-----------------------------------|-------------------------|
|   |                                   | Level 1            | Estimated fair value |           |            | Carrying or<br>notional<br>amount | Estimated<br>fair value |
|   |                                   |                    | Level 2              | Level 3   |            |                                   |                         |
| <b>Financial assets</b>   |                                   |                    |                      |           |            |                                   |                         |
| Cash and cash equivalents,<br>excluding money market<br>funds       | \$ 168,502                        | \$                 | \$ 168,502           | \$        | \$ 168,502 | \$ 270,255                        | \$ 270,255              |
| Money market funds  | 10                                |                    | 10                   |           | 10         | 10                                | 10                      |
| Available-for-sale<br>investment and<br>mortgage-related securities | 664,051                           |                    | 664,051              |           | 664,051    | 624,331                           | 624,331                 |
| Investment in stock of<br>Federal Home Loan Bank<br>of Seattle      | 96,893                            |                    | 96,893               |           | 96,893     | 97,764                            | 97,764                  |
| Loans receivable, net   | 3,722,243                         |                    |                      | 3,948,690 | 3,948,690  | 3,652,419                         | 3,886,253               |
| <b>Financial liabilities</b>  |                                   |                    |                      |           |            |                                   |                         |
| Deposit liabilities   | 4,126,788                         |                    | 4,133,347            |           | 4,133,347  | 4,070,032                         | 4,075,656(1)            |
| Short-term<br>borrowings other than bank                            | 82,219                            |                    | 82,219               |           | 82,219     | 68,821                            | 68,821                  |
| Other bank borrowings   | 211,219                           |                    | 228,533              |           | 228,533    | 233,229                           | 250,486                 |
| Long-term debt, net other<br>than bank                              | 1,429,869                         |                    | 1,491,860            |           | 1,491,860  | 1,340,070                         | 1,400,241               |

(1) Revised (increased by \$83.9 million) to correct an error in the estimated fair value disclosure at December 31, 2011.

As of September 30, 2012 and December 31, 2011, loan commitments and unused lines and letters of credit issued by ASB had notional amounts of \$1.5 billion and \$1.3 billion, respectively, and their estimated fair value on such dates were \$2.1 million and \$0.3 million, respectively. As of September 30, 2012 and December 31, 2011, loans serviced by ASB for others had notional amounts of \$1.2 billion and \$993 million, respectively, and the estimated fair value of the servicing rights for such loans was \$11.5 million and \$9.8 million, respectively.

**Fair value measurements on a recurring basis.** While securities held in ASB's investment portfolio trade in active markets, they do not trade on listed exchanges nor do the specific holdings trade in quoted markets by dealers or brokers. All holdings are valued using market-based approaches that are based on exit prices that are taken from identical or similar market transactions, even in situations where trading volume may be low when compared with prior periods as has been the case during the recent market disruption. Inputs to these valuation techniques reflect the assumptions that consider credit and nonperformance risk that market participants would use in pricing the asset based on market data obtained from independent sources. Available-for-sale securities were comprised of federal agency obligations and mortgage-backed securities and municipal bonds.

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Assets measured at fair value on a recurring basis were as follows:

| (in thousands)                                   | Fair value measurements |            |         |
|--|-------------------------|------------|---------|
|  | Level 1                 | Level 2    | Level 3 |
| <b>September 30, 2012</b>                        |                         |            |         |
| Money market funds ( other segment)              | \$                      | \$ 10      | \$      |
| Available-for-sale securities (bank segment)     |                         |            |         |
| Mortgage-related securities-FNMA, FHLMC and GNMA | \$                      | \$ 364,620 | \$      |
| Federal agency obligations                       |                         | 216,583    |         |
| Municipal bonds                                  |                         | 82,848     |         |
|  | \$                      | \$ 664,051 | \$      |
| <b>December 31, 2011</b>                         |                         |            |         |
| Money market funds ( other segment)              | \$                      | \$ 10      | \$      |
| Available-for-sale securities (bank segment)     |                         |            |         |
| Mortgage-related securities-FNMA, FHLMC and GNMA | \$                      | \$ 344,865 | \$      |
| Federal agency obligations                       |                         | 220,727    |         |
| Municipal bonds                                  |                         | 58,739     |         |
|  | \$                      | \$ 624,331 | \$      |

**Fair value measurements on a nonrecurring basis.** From time to time, the Company may be required to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the writedowns of individual assets. ASB does not record loans at fair value on a recurring basis. However, from time to time, ASB records nonrecurring fair value adjustments based on the current appraised value of the collateral securing the loans or unobservable market assumptions. Unobservable assumptions reflect ASB's own estimate of the fair value of collateral used in valuing the loan. ASB may also be required to measure goodwill at fair value on a nonrecurring basis. During the first nine months of 2012, it was not required that a measurement of the fair value of goodwill be calculated and goodwill was not measured at fair value.

Assets measured at fair value on a nonrecurring basis were as follows:

| (in millions)      | Balance | Fair value measurements |         |         |
|--------------------|---------|-------------------------|---------|---------|
|                    |         | Level 1                 | Level 2 | Level 3 |
| <b>Loans</b>       |         |                         |         |         |
| September 30, 2012 | \$ 24   | \$                      | \$      | \$ 24   |
| December 31, 2011  | 34      |                         |         | 34      |

For the first nine months of 2012 and 2011, there were no adjustments to fair value for ASB's loans held for sale.

**Residential loans.** The fair value of ASB's residential loans that were written down due to impairment was determined based on third party appraisals for similar residential property sales in an active market, and therefore, is classified as a Level 3 measurement.



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Home equity lines of credit. The fair value of ASB's home equity lines of credit that were written down due to impairment was determined based on third party appraisals for similar residential property sales in an active market, and therefore, is classified as a Level 3 measurement.

Commercial loans. The fair value of ASB's commercial loans that were written down due to impairment was determined based on third party appraisals for the specific properties, the value placed on the assets of the business and cash flows generated by the business entity, and therefore, is classified as a Level 3 measurement.

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For loans classified as Level 3 as of September 30, 2012, the significant unobservable inputs used in the fair value measurement were as follows:

| (\$ in thousands)           | Fair value at<br>September 30,<br>2012 | Valuation technique         | Significant unobservable input  | Significant<br>unobservable<br>input value |
|-----------------------------|--|-----------------------------|---|--|
| Residential loans           | \$ 20,088                              | Third party appraisal       | Property sales  | 64%  |
| Home equity lines of credit | 649                                    | Third party appraisal       | Property sales  | 42%  |
| Commercial loan             | 14                                     | Third party appraisal       | U.S. government agency guarantee  | 85%  |
| Commercial loans            | 738                                    | Third party appraisal       | Fair value of business assets   | 45%  |
| Commercial loan             | 1,998                                  | Present value of cash flows | Present value of expected future cash flows based on anticipated debt restructuring | Paydown of loan<br>62%                     |
|                             |  |                             | Discount rate   | 4.5%                                       |
| Commercial loan             | 227                                    | Third party appraisal       | Insurance proceeds  | 60%  |

Significant increases (decreases) in any of those inputs in isolation would result in significantly higher (lower) fair value measurement.

**10 • Cash flows**

| Nine months ended September 30<br>(in millions)   | 2012  | 2011  |
|---|-------|-------|
| <b>Supplemental disclosures of cash flow information</b>                                |       |       |
| Interest paid to non-affiliates   | \$ 61 | \$ 74 |
| Income tax paid/(refunded) (1)  |       | (19)  |
| <b>Supplemental disclosures of noncash activities</b>                                   |       |       |
| Common stock dividends reinvested in HEI common stock (2)                               | 18    | 12    |
| Increases in common stock related to director and officer compensatory plans            | 5     | 6     |
| Additions to electric utility property, plant and equipment - Unpaid invoices and other | 27    | 21    |
| Real estate acquired in settlement of loans   | 7     | 8     |

(1) For the nine months ended September 30, 2012, estimated taxes paid were offset by refunds from the settlement of IRS examinations of prior years. For the nine months ended September 30, 2011, tax refunds resulted from repairs deductions and bonus depreciation taken in 2009 and 2010.

(2) The amounts shown represent common stock dividends reinvested in HEI common stock under the HEI Dividend Reinvestment and Stock Purchase Plan (DRIP) in noncash transactions.

**11 • Credit agreement**

HEI maintains an amended revolving noncollateralized credit agreement, which established a line of credit facility of \$125 million, with a letter of credit sub-facility, expiring on December 5, 2016, with a syndicate of eight financial institutions. The credit facility will be maintained to support the issuance of commercial paper, but also may be drawn to repay HEI's short-term and long-term indebtedness, to make investments in or loans to subsidiaries and for HEI's working capital and general corporate purposes.

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Statements of Income (unaudited)**

| (in thousands)  | Three months ended<br>September 30 |                  | Nine months ended<br>September 30 |                  |
|---|------------------------------------|------------------|-----------------------------------|------------------|
|   | 2012                               | 2011             | 2012                              | 2011             |
| <b>Operating revenues</b>                             | \$ 799,203                         | \$ 818,907       | \$ 2,334,826                      | \$ 2,190,860     |
| <b>Operating expenses</b>                             |                                    |                  |                                   |                  |
| Fuel oil  | 327,173                            | 352,475          | 986,076                           | 925,476          |
| Purchased power                                       | 186,699                            | 188,484          | 539,840                           | 508,179          |
| Other operation                                       | 70,441                             | 61,415           | 196,806                           | 194,334          |
| Maintenance   | 30,368                             | 32,336           | 91,641                            | 92,808           |
| Depreciation  | 35,941                             | 34,983           | 108,556                           | 107,673          |
| Taxes, other than income taxes                        | 74,850                             | 75,355           | 222,149                           | 202,502          |
| Income taxes  | 22,352                             | 23,860           | 58,291                            | 46,630           |
| Total operating expenses                              | 747,824                            | 768,908          | 2,203,359                         | 2,077,602        |
| <b>Operating income</b>                               | <b>51,379</b>                      | <b>49,999</b>    | <b>131,467</b>                    | <b>113,258</b>   |
| <b>Other income</b>                                   |                                    |                  |                                   |                  |
| Allowance for equity funds used during construction   | 1,611                              | 1,570            | 5,548                             | 4,131            |
| Other, net  | 1,045                              | 1,170            | 3,673                             | 2,978            |
| Total other income                                    | 2,656                              | 2,740            | 9,221                             | 7,109            |
| <b>Interest and other charges</b>                     |                                    |                  |                                   |                  |
| Interest on long-term debt                            | 14,694                             | 14,383           | 44,400                            | 43,149           |
| Amortization of net bond premium and expense          | 870                                | 767              | 2,276                             | 2,316            |
| Other interest charges (credits)                      | 286                                | (210)            | (84)                              | 965              |
| Allowance for borrowed funds used during construction | (688)                              | (658)            | (2,451)                           | (1,731)          |
| Total interest and other charges                      | 15,162                             | 14,282           | 44,141                            | 44,699           |
| <b>Net income</b>                                     | <b>38,873</b>                      | <b>38,457</b>    | <b>96,547</b>                     | <b>75,668</b>    |
| Preferred stock dividends of subsidiaries             | 228                                | 228              | 686                               | 686              |
| <b>Net income attributable to HECO</b>                | <b>38,645</b>                      | <b>38,229</b>    | <b>95,861</b>                     | <b>74,982</b>    |
| Preferred stock dividends of HECO                     | 270                                | 270              | 810                               | 810              |
| <b>Net income for common stock</b>                    | <b>\$ 38,375</b>                   | <b>\$ 37,959</b> | <b>\$ 95,051</b>                  | <b>\$ 74,172</b> |

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

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

Hawaiian Electric Company, Inc. and Subsidiaries

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

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| (in thousands)  | Three months ended |           | Nine months ended |           |
|---|--------------------|-----------|-------------------|-----------|
|   | September 30       |           | September 30      |           |
|   | 2012               | 2011      | 2012              | 2011      |
| Net income for common stock   | \$ 38,375          | \$ 37,959 | \$ 95,051         | \$ 74,172 |
| Other comprehensive income, net of taxes:   |                    |           |                   |           |
| Retirement benefit plans:   |                    |           |                   |           |
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of tax benefits of \$2,178 and \$1,150 for the three months ended September 30, 2012 and 2011 and \$6,532 and \$3,999 for the nine months ended September 30, 2012 and 2011, respectively | 3,419              | 1,854     | 10,255            | 6,280     |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory assets, net of taxes of \$2,129 and \$1,074 for the three months ended September 30, 2012 and 2011 and \$6,386 and \$3,875 for the nine months ended September 30, 2012 and 2011, respectively                             | (3,342)            | (1,732)   | (10,026)          | (6,084)   |
| Other comprehensive income, net of taxes  | 77                 | 122       | 229               | 196       |
| Comprehensive income attributable to common shareholder   | \$ 38,452          | \$ 38,081 | \$ 95,280         | \$ 74,368 |

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

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Balance Sheets (unaudited)**

| (dollars in thousands, except par value)  | September 30,<br>2012 | December 31,<br>2011 |
|---|-----------------------|----------------------|
| <b>Assets</b>   |                       |                      |
| <b>Utility plant, at cost</b>   |                       |                      |
| Land  | \$ 51,544             | \$ 51,514            |
| Plant and equipment   | 5,245,769             | 5,052,027            |
| Less accumulated depreciation   | (2,026,450)           | (1,966,894)          |
| Construction in progress  | 176,216               | 138,838              |
| <b>Net utility plant</b>  | <b>3,447,079</b>      | <b>3,275,485</b>     |
| <b>Current assets</b>   |                       |                      |
| Cash and cash equivalents   | 15,722                | 48,806               |
| Customer accounts receivable, net   | 226,933               | 183,328              |
| Accrued unbilled revenues, net  | 132,090               | 137,826              |
| Other accounts receivable, net  | 1,925                 | 8,623                |
| Fuel oil stock, at average cost   | 202,920               | 171,548              |
| Materials and supplies, at average cost   | 50,493                | 43,188               |
| Prepayments and other   | 64,006                | 36,667               |
| Regulatory assets   | 25,103                | 20,283               |
| <b>Total current assets</b>   | <b>719,192</b>        | <b>650,269</b>       |
| <b>Other long-term assets</b>   |                       |                      |
| Regulatory assets   | 690,891               | 649,106              |
| Unamortized debt expense  | 10,786                | 12,786               |
| Other   | 93,767                | 86,361               |
| <b>Total other long-term assets</b>   | <b>795,444</b>        | <b>748,253</b>       |
| <b>Total assets</b>   | <b>\$ 4,961,715</b>   | <b>\$ 4,674,007</b>  |
| <b>Capitalization and liabilities</b>   |                       |                      |
| <b>Capitalization</b>   |                       |                      |
| Common stock (\$6 2/3 par value, authorized 50,000,000 shares; outstanding 14,233,723 shares) | \$ 94,911             | \$ 94,911            |
| Premium on capital stock  | 426,921               | 426,921              |
| Retained earnings   | 921,309               | 881,041              |
| Accumulated other comprehensive income (loss), net of income taxes                            | 197                   | (32)                 |
| <b>Common stock equity</b>  | <b>1,443,338</b>      | <b>1,402,841</b>     |
| Cumulative preferred stock not subject to mandatory redemption                                | 34,293                | 34,293               |
| Long-term debt, net   | 1,147,869             | 1,000,570            |
| <b>Total capitalization</b>   | <b>2,625,500</b>      | <b>2,437,704</b>     |
| <b>Commitments and contingencies (Note 5)</b>   |                       |                      |
| <b>Current liabilities</b>  |                       |                      |
| Short-term borrowings nonaffiliates   | 44,719                |                      |
| Current portion of long-term debt   |                       | 57,500               |
| Accounts payable  | 211,999               | 188,580              |
| Interest and preferred dividends payable  | 22,458                | 19,483               |
| Taxes accrued   | 235,302               | 230,076              |
| Other   | 62,584                | 69,353               |
| <b>Total current liabilities</b>  | <b>577,062</b>        | <b>564,992</b>       |
| <b>Deferred credits and other liabilities</b>   |                       |                      |
| Deferred income taxes   | 420,724               | 337,863              |
| Regulatory liabilities  | 319,330               | 315,466              |
| Unamortized tax credits   | 64,178                | 60,614               |
| Retirement benefits liability   | 463,599               | 495,121              |
| Other   | 103,459               | 106,044              |

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|   |                     |                     |
|---|---------------------|---------------------|
| <b>Total deferred credits and other liabilities</b> | 1,371,290           | 1,315,108           |
| Contributions in aid of construction                | 387,863             | 356,203             |
| <b>Total capitalization and liabilities</b>         | <b>\$ 4,961,715</b> | <b>\$ 4,674,007</b> |

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

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidated Statements of Changes in Common Stock Equity (unaudited)**

| (in thousands)                           | Common stock  |                  | Premium<br>on<br>capital<br>stock | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Total               |
|--|---------------|------------------|-----------------------------------|----------------------|--|---------------------|
|  | Shares        | Amount           |                                   |                      |  |                     |
| <b>Balance, December 31, 2011</b>        | <b>14,234</b> | <b>\$ 94,911</b> | <b>\$ 426,921</b>                 | <b>\$ 881,041</b>    | <b>\$ (32)</b>   | <b>\$ 1,402,841</b> |
| Net income for common stock              |               |                  |                                   | 95,051               |  | 95,051              |
| Other comprehensive income, net of taxes |               |                  |                                   |                      | 229  | 229                 |
| Common stock dividends                   |               |                  |                                   | (54,783)             |  | (54,783)            |
| <b>Balance, September 30, 2012</b>       | <b>14,234</b> | <b>\$ 94,911</b> | <b>\$ 426,921</b>                 | <b>\$ 921,309</b>    | <b>\$ 197</b>  | <b>\$ 1,443,338</b> |
| <b>Balance, December 31, 2010</b>        | <b>13,831</b> | <b>\$ 92,224</b> | <b>\$ 389,609</b>                 | <b>\$ 851,613</b>    | <b>\$ 709</b>  | <b>\$ 1,334,155</b> |
| Net income for common stock              |               |                  |                                   | 74,172               |  | 74,172              |
| Other comprehensive income, net of taxes |               |                  |                                   |                      | 196  | 196                 |
| Common stock dividends                   |               |                  |                                   | (52,919)             |  | (52,919)            |
| <b>Balance, September 30, 2011</b>       | <b>13,831</b> | <b>\$ 92,224</b> | <b>\$ 389,609</b>                 | <b>\$ 872,866</b>    | <b>\$ 905</b>  | <b>\$ 1,355,604</b> |

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



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Hawaiian Electric Company, Inc. and Subsidiaries

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

| Nine months ended September 30<br>(in thousands)  | 2012             | 2011             |
|---|------------------|------------------|
| <b>Cash flows from operating activities</b>   |                  |                  |
| Net income  | \$ 96,547        | \$ 75,668        |
| Adjustments to reconcile net income to net cash provided by operating activities  |                  |                  |
| Depreciation of property, plant and equipment   | 108,556          | 107,673          |
| Other amortization  | 4,074            | 12,694           |
| Change in deferred income taxes   | 82,717           | 51,120           |
| Change in tax credits, net  | 3,642            | 1,416            |
| Allowance for equity funds used during construction   | (5,548)          | (4,131)          |
| Change in cash overdraft  |                  | (2,688)          |
| Changes in assets and liabilities   |                  |                  |
| Increase in accounts receivable   | (36,907)         | (42,966)         |
| Decrease (increase) in accrued unbilled revenues  | 5,736            | (33,503)         |
| Increase in fuel oil stock  | (31,372)         | (4,592)          |
| Increase in materials and supplies  | (7,305)          | (5,280)          |
| Increase in regulatory assets   | (57,793)         | (34,231)         |
| Decrease in accounts payable  | (3,481)          | (59,526)         |
| Change in prepaid and accrued income taxes and utility revenue taxes  | (20,665)         | 44,498           |
| Contributions to defined benefit pension and other postretirement benefit plans   | (62,417)         | (55,235)         |
| Change in other assets and liabilities  | 4,228            | 9,551            |
| <b>Net cash provided by operating activities</b>  | <b>80,012</b>    | <b>60,468</b>    |
| <b>Cash flows from investing activities</b>   |                  |                  |
| Capital expenditures  | (220,970)        | (142,734)        |
| Contributions in aid of construction  | 33,106           | 15,106           |
| Other   |                  | 77               |
| <b>Net cash used in investing activities</b>  | <b>(187,864)</b> | <b>(127,551)</b> |
| <b>Cash flows from financing activities</b>   |                  |                  |
| Common stock dividends  | (54,783)         | (52,919)         |
| Preferred stock dividends of HECO and subsidiaries  | (1,496)          | (1,496)          |
| Proceeds from issuance of long-term debt  | 457,000          |                  |
| Repayment of long-term debt   | (368,500)        |                  |
| Net increase in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or less | 44,719           | 12,498           |
| Other   | (2,172)          | (67)             |
| <b>Net cash provided by (used in) financing activities</b>  | <b>74,768</b>    | <b>(41,984)</b>  |
| Net decrease in cash and cash equivalents   | (33,084)         | (109,067)        |
| Cash and cash equivalents, beginning of period  | 48,806           | 122,936          |
| <b>Cash and cash equivalents, end of period</b>   | <b>\$ 15,722</b> | <b>\$ 13,869</b> |

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

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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 and the following notes 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, 2011 and the unaudited consolidated financial statements and the notes thereto in HECO's Quarterly Reports on SEC Form 10-Q for the quarters ended March 31, 2012 and June 30, 2012.

In the opinion of HECO's management, the accompanying unaudited consolidated financial statements contain all material adjustments required by GAAP to fairly state the financial position of HECO and its subsidiaries as of September 30, 2012 and December 31, 2011, the results of their operations for the three and nine months ended September 30, 2012 and 2011 and their cash flows for the nine months ended September 30, 2012 and 2011. 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. The December 31, 2011 balance sheet information has been derived from the HECO 2011 financial statements. When required, certain reclassifications are made to the prior period's consolidated financial statements to conform to the current presentation.

HECO and its subsidiaries revised their previously issued financial statements to correct an error that resulted in the understatement of franchise taxes, net of tax benefits, that should have been recorded in years prior to 2010. HECO and its subsidiaries determined the cumulative impact for periods prior to 2010 to be a charge to earnings of \$3.2 million. These adjustments were not considered to be material individually or in the aggregate to previously issued financial statements. The table below illustrates the effects of this revision on HECO and its subsidiaries Consolidated Financial Statements for those line items affected (these revisions have no impact on HECO and its subsidiaries' Consolidated Statements of Income and Cash Flows for the periods reported):

| (in thousands)                    | As previously filed | As revised | Difference |
|-----------------------------------|---------------------|------------|------------|
| <b>December 31, 2011</b>          |                     |            |            |
| <b>Consolidated Balance Sheet</b> |                     |            |            |
| Prepayments and other             | \$ 34,602           | \$ 36,667  | \$ 2,065   |
| Total current assets              | 648,204             | 650,269    | 2,065      |
| Total assets                      | 4,671,942           | 4,674,007  | 2,065      |
| Retained earnings                 | 884,284             | 881,041    | (3,243)    |
| Common stock equity               | 1,406,084           | 1,402,841  | (3,243)    |
| Total capitalization              | 2,440,947           | 2,437,704  | (3,243)    |
| Taxes accrued                     | 224,768             | 230,076    | 5,308      |

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|                                      |           |           |       |
|--------------------------------------|-----------|-----------|-------|
| Total current liabilities            | 559,684   | 564,992   | 5,308 |
| Total capitalization and liabilities | 4,671,942 | 4,674,007 | 2,065 |

**Consolidated Statement of Changes in Common Stock**

**Equity**

|                     |           |           |         |
|---------------------|-----------|-----------|---------|
| Retained earnings   | 884,284   | 881,041   | (3,243) |
| Common stock equity | 1,406,084 | 1,402,841 | (3,243) |

**December 31, 2010**

**Consolidated Statement of Changes in Common Stock**

**Equity**

|                     |           |           |         |
|---------------------|-----------|-----------|---------|
| Retained earnings   | 854,856   | 851,613   | (3,243) |
| Common stock equity | 1,337,398 | 1,334,155 | (3,243) |

Table of Contents**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 Hawaii Electric Light Company, Inc. (HELCO) and Maui Electric Company, Limited (MECO) each in the principal amount of \$10 million, (iii) making distributions on these 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 currently redeemable at the issuer's option without premium. The 2004 Debentures, together with the obligations of HECO, HELCO and MECO under an expense agreement and HECO's obligations under its trust guarantee and its guarantee of the obligations of HELCO and MECO under their respective debentures, are the sole assets of Trust III. Trust III has at all times been an unconsolidated subsidiary of HECO. Since HECO, as the common security holder, does not absorb the majority of the variability of Trust III, HECO is not the primary beneficiary and does not consolidate Trust III in accordance with accounting rules on the consolidation of VIEs. Trust III's balance sheets as of September 30, 2012 and December 31, 2011 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 the nine months ended September 30, 2012 and 2011 each consisted of \$2.5 million of interest income received from the 2004 Debentures, \$2.4 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 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.

**Power purchase agreements.** As of September 30, 2012, HECO and its subsidiaries had six PPAs for firm capacity and other PPAs with smaller independent power producers (IPPs) and Schedule Q providers (i.e., customers with cogeneration and/or small power production facilities with a capacity of 100 kW or less who buy power from or sell power to the utilities), none of which are currently required to be consolidated as VIEs. Approximately 90% of the firm capacity is purchased from AES Hawaii, Inc. (AES Hawaii), Kalaeloa Partners, L.P. (Kalaeloa), Hamakua Energy Partners, L.P. (HEP) and HPOWER. Purchases from all IPPs for the quarter ended September 30, 2012 totaled \$187 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling \$38 million, \$78 million, \$19 million, and \$18 million, respectively. Purchases for all IPPs for the quarter ended September 30, 2011 totaled \$188 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling \$35 million, \$87 million, \$19 million, and \$16 million, respectively. Purchases from all IPPs for the nine months ended September 30, 2012 totaled \$540 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling \$109 million, \$230 million, \$48 million, and \$48 million, respectively. Purchases for all IPPs for the nine months ended September 30, 2011 totaled \$508 million, with purchases from AES Hawaii, Kalaeloa, HEP and HPOWER totaling \$106 million, \$226 million, \$44 million, and \$45 million, respectively.

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, and thus excluded from the scope of accounting standards for VIEs. A windfarm and Kalaeloa provided sufficient information, as required under their PPAs or amendments, such that HECO could determine that consolidation was not required. Management has concluded that the consolidation of some IPPs is not required as HECO and its subsidiaries do not have variable interests in the IPPs because the PPAs do not require them to absorb any variability of the IPPs.

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 accounting standards for VIEs to that entity if the enterprise is unable to obtain the necessary information after making an exhaustive effort. HECO and its subsidiaries have made and



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continue to make exhaustive efforts to get the necessary information from two firm capacity producers and other small IPPs who entered into their PPAs prior to December 31, 2003 and have not provided such information, but have been unsuccessful to date as it was not a contractual requirement to provide such information prior to 2004. If the requested information is ultimately received from the remaining IPPs, a possible outcome of future analyses of such information is the consolidation of one or more of such IPPs. The consolidation of any significant IPP could have a material effect on the Company's and HECO's consolidated financial statements, including the recognition of a significant amount of assets and liabilities and the potential recognition of losses. If HECO and its subsidiaries determine they are required to consolidate the financial statements of such an IPP and the consolidation has a material effect, HECO and its subsidiaries would retrospectively apply accounting standards for VIEs.

**3 • Revenue taxes**

HECO and its subsidiaries' operating revenues include amounts for various Hawaii state revenue taxes. Revenue taxes are generally recorded as an expense in the period the related revenues are recognized. However, HECO and its subsidiaries' revenue tax payments to the taxing authorities in the period are based on the prior year's billed revenues (in the case of public service company taxes and PUC fees) or on the current year's cash collections from electric sales (in the case of franchise taxes). For the nine months ended September 30, 2012 and 2011, HECO and its subsidiaries included approximately \$212 million and \$193 million, respectively, of revenue taxes in operating revenues and in taxes, other than income taxes expense.

**4 • Retirement benefits**

**Defined benefit pension and other postretirement benefit plans information.** For the first nine months of 2012, HECO and its subsidiaries contributed \$62 million to their retirement benefit plans, compared to \$55 million in the first nine months of 2011. HECO and its subsidiaries' current estimate of contributions to their retirement benefit plans in 2012 is \$63 million, compared to contributions of \$73 million in 2011. In addition, HECO and its subsidiaries expect to pay directly \$0.8 million of benefits in 2012, compared to \$1.3 million paid in 2011.

On July 6, 2012, President Obama signed the Moving Ahead for Progress in the 21st Century Act (MAP-21), which included provisions related to the funding and administration of pension plans. This law does not affect the utilities' accounting for pension benefits; therefore, the net periodic benefit costs disclosed for the plans were not affected. The utilities elected to apply MAP-21 for 2012, which reduced the 2012 minimum funding requirement and lifted the restrictions on accelerated distribution options (which restrictions were in effect April 1, 2011 to September 30, 2012) for HECO and its subsidiaries. If the Adjusted Funding Target Attainment Percentage falls below 80% in the future, the restrictions on accelerated distribution options may apply again.

The Pension Protection Act provides that if a pension plan's funded status falls below certain levels, more conservative assumptions must be used to value obligations under the pension plan. The HEI Retirement Plan fell below these thresholds in 2011 and the minimum required contribution for 2012 incorporates the more conservative assumptions required. Other factors could cause changes to the required contribution levels.



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The components of net periodic benefit cost were as follows:

| (in thousands)  | Three months ended September 30 |           |                |         | Nine months ended September 30 |           |                |          |
|---|---------------------------------|-----------|----------------|---------|--------------------------------|-----------|----------------|----------|
|   | Pension benefits                |           | Other benefits |         | Pension benefits               |           | Other benefits |          |
|   | 2012                            | 2011      | 2012           | 2011    | 2012                           | 2011      | 2012           | 2011     |
| Service cost  | \$ 10,400                       | \$ 8,182  | \$ 1,003       | \$ 827  | \$ 31,202                      | \$ 25,221 | \$ 3,010       | \$ 3,179 |
| Interest cost   | 15,364                          | 14,656    | 2,175          | 2,197   | 46,090                         | 44,308    | 6,527          | 6,921    |
| Expected return on plan assets                              | (16,001)                        | (15,574)  | (2,548)        | (2,655) | (48,003)                       | (46,210)  | (7,646)        | (7,881)  |
| Amortization of net transition obligation                   |                                 |           | (2)            | (2)     |                                |           | (6)            | (6)      |
| Amortization of net prior service gain                      | (173)                           | (187)     | (450)          | (590)   | (517)                          | (561)     | (1,352)        | (1,129)  |
| Amortization of net actuarial loss                          | 5,857                           | 3,679     | 363            | 104     | 17,571                         | 11,815    | 1,091          | 159      |
| Net periodic benefit cost                                   | 15,447                          | 10,756    | 541            | (119)   | 46,343                         | 34,573    | 1,624          | 1,243    |
| Impact of PUC D&Os  | (3,460)                         | (713)     | (552)          | 327     | (12,294)                       | (2,813)   | (1,648)        | 3,079    |
| Net periodic benefit cost (adjusted for impact of PUC D&Os) | \$ 11,987                       | \$ 10,043 | \$ (11)        | \$ 208  | \$ 34,049                      | \$ 31,760 | \$ (24)        | \$ 4,322 |

HECO and its subsidiaries recorded retirement benefits expense of \$24 million and \$27 million for the first nine months of 2012 and 2011, respectively. The electric utilities charged a portion of the net periodic benefit cost to electric utility plant.

The utilities have implemented pension and OPEB tracking mechanisms under which all of their retirement benefit expenses (except for executive life and nonqualified pension plan expenses) determined in accordance with GAAP are recovered over time.

**Defined contribution plan information.** For the first nine months of 2012 and 2011, the utilities' expense for defined contribution pension plan was \$0.2 million and de minimis, respectively.

**5 • Commitments and contingencies**

**Hawaii Clean Energy Initiative.** In January 2008, the State of Hawaii (State) and the U.S. Department of Energy signed a memorandum of understanding establishing the Hawaii Clean Energy Initiative (HCEI). In October 2008, the Governor of the State, the State Department of Business, Economic Development and Tourism, the Division of Consumer Advocacy of the State Department of Commerce and Consumer Affairs, and HECO, on behalf of itself and its subsidiaries, HELCO and MECO (collectively, the parties), signed an agreement setting forth goals and objectives under the HCEI and the related commitments of the parties (the Energy Agreement), including pursuing a wide range of actions to decrease the State's dependence on imported fossil fuels through substantial increases in renewable energy and programs intended to secure greater energy efficiency and conservation. Many of the actions and programs included in the Energy Agreement require approval of the PUC.



**Renewable energy projects.** HECO and its subsidiaries continue to negotiate with developers of proposed projects to integrate power into its grid from a variety of renewable energy sources, including solar, biomass, wind, ocean thermal energy conversion, wave and others. This includes HECO's plan to integrate wind power into the Oahu electrical grid that would be imported via a yet-to-be-built undersea transmission cable system from a large windfarm proposed to be built on the island of Lanai.

In December 2009, the PUC allowed HECO to defer the costs of studies for the large wind project for later review of prudence and reasonableness, and HECO is now seeking PUC approval to recover the deferred costs totaling \$3.9 million for the Stage 1 studies through the REIP surcharge. A decision from the PUC is pending.

In November 2011, HECO and MECO filed their application to seek PUC approval to defer for later recovery approximately \$555,000 (split evenly between HECO and MECO) also through the REIP surcharge for additional studies to determine the value proposition of interconnecting the islands of Oahu and of Maui County (Maui, Lanai, and Molokai) and if doing so would be operationally beneficial and cost-effective. In August 2012, the PUC allowed HECO and MECO to defer the outside service costs for the additional studies for later review of prudence and reasonableness. The specific amount to be recovered, as well as the recovery mechanism and the terms of the recovery mechanism, will be determined at a later date.

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A revised draft Request for Proposals (RFP) for 200 MW or more of renewable energy to be delivered to Oahu from any of the Hawaiian Islands has been posted on the HECO website prior to the issuance of a proposed final RFP. In February 2012, the PUC granted HECO's request for deferred accounting treatment for the inter-island project support costs. The amount of the deferred costs was limited to \$5.89 million.

In May 2012, the PUC instituted a proceeding for a competitive bidding process for up to 50 MW of firm renewable geothermal dispatchable energy (Geothermal RFP) on the island of Hawaii, and in July 2012, HELCO filed an application to defer costs related to the Geothermal RFP.

**Interim increases.** As of September 30, 2012, HECO and its subsidiaries had recognized \$4 million of revenues with respect to interim orders related to general rate increase requests. Revenue amounts recorded pursuant to interim orders are subject to refund, with interest, if they exceed amounts allowed in a final order.

**Major projects.** Many public utility projects require PUC approval and various permits from other governmental agencies. Difficulties in obtaining, or the inability to obtain, the necessary approvals or permits can result in significantly increased project costs or even cancellation of projects. Further, completion of projects is subject to various risks, such as problems or disputes with vendors. In the event a project does not proceed, or if it becomes probable the PUC will disallow cost recovery for all or part of a project, project costs may need to be written off in amounts that could result in significant reductions in HECO's consolidated net income. Significant projects whose costs (or costs in excess of estimates) have not yet been allowed in rate base by a final PUC order include those described below.

In May 2011, the PUC ordered independently conducted regulatory audits on the reasonableness of costs incurred for HECO's East Oahu Transmission Project (EOTP), Campbell Industrial Park (CIP) combustion turbine No. 1 (CT-1) project, and Customer Information System (CIS) project. The PUC subsequently eliminated the requirement for a regulatory audit for the EOTP Phase I. The PUC has not yet issued a schedule or requirements for the regulatory audits of the CIP CT-1 and CIS projects or determined if an audit for EOTP Phase 2 will be required.

Campbell Industrial Park combustion turbine No. 1 and transmission line. HECO's incurred costs for this project, which was placed in service in 2009, were \$195 million, including \$9 million of AFUDC. HECO's current rates reflect recovery of \$163 million of these project costs. In July 2011, the PUC allowed HECO to defer the portion of costs that are in excess of the prior PUC approved amounts and related depreciation for HECO's CIP CT-1 project (\$32 million) until completion of an independently conducted regulatory audit. The PUC also approved the accrual of a carrying charge on the cost of the project not yet included in rates and the related depreciation expense, from July 1, 2011 until the regulatory audit is completed and allowed the remaining project costs that were not deferred to be included in electric rates. For accounting purposes, HECO will recognize the equity portion of the carrying charge when it is collected in electric rates. Management believes no adjustment to project costs is required as of September 30, 2012.

East Oahu Transmission Project. HECO had planned a project to construct a partially underground transmission line to a major substation. However, in 2002, an application for a permit, which would have allowed construction in a route through conservation district lands, was denied. In 2007, the PUC approved HECO's request to expend funds for a revised EOTP in two phases (then estimated at \$56 million - \$42 million for Phase 1 and \$14 million for Phase 2).

Phase 1 was placed in service in June 2010 at a cost of \$59 million. The interim D&O issued in July 2011 in HECO's 2011 test year rate case reflected approximately \$16 million of Phase 1 costs and related depreciation expense in determining revenue requirements. In that D&O, the

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PUC ordered that a regulatory audit was to be conducted before the PUC determined the recoverability of the remaining Phase 1 costs.

In March 2012, the PUC approved a settlement agreement reached among HECO, the Consumer Advocate and the Department of Defense, under which, in lieu of a regulatory audit, HECO would write-off \$9.5 million of Phase 1 gross plant in service and associated adjustments. This resulted in an after-tax charge to net income in the fourth quarter of 2011 of approximately \$6 million and the elimination of the requirement for a Phase 1 regulatory audit. The PUC also provided for an additional increase of approximately \$5 million in HECO's 2011 test year rate case for the additional revenue requirements reflecting all remaining Phase 1 costs not previously included in rates or agreed to be written off.

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In April 2010, HECO proposed a modification of Phase 2 of the EOTP that uses smart grid technology and is estimated to cost \$10 million (total cost of \$15 million, less \$5 million of funding through the Smart Grid Investment Grant Program). In October 2010, the PUC approved HECO's modification request for Phase 2, which was placed in service in August 2012. As of September 30, 2012, HECO's incurred costs for the Modified Phase 2 project amounted to \$10.9 million (total cost of \$15.4 million, less \$4.5 million received in Smart Grid Investment Grant funding). Management also expects to receive an additional \$0.5 million in Smart Grid Investment Grant funding. Management believes that no adjustment to project costs of EOTP Modified Phase 2 is required as of September 30, 2012.

*Customer Information System Project.* In 2005, the PUC approved the utilities' request to (i) expend the then-estimated \$20 million (including \$18 million for capital and deferred costs) for a new CIS project, provided that no part of the project costs may be included in rate base until the project is in service and is used and useful for public utility purposes, and (ii) defer certain computer software development costs, accumulate AFUDC during the deferral period, amortize the deferred costs over a specified period and include the unamortized deferred costs in rate base, subject to specified conditions.

The CIS project's new software system became operational in May 2012. As of September 30, 2012, the utilities' total deferred and capital costs for the CIS project were \$59 million. In February 2012 and May 2012, the PUC granted HECO's and MECO's requests, respectively, to defer CIS project operation and maintenance expenses (limited to \$2.3 million per year in 2011 and 2012 for HECO and limited to \$0.6 million in 2012 for MECO) that are to be subject to a regulatory audit. The PUC also allowed them to accrue AFUDC on project costs (including deferred operation and maintenance expenses) until the completion of the regulatory audit and begin amortization of such costs when the amortization is included in rates. HELCO anticipates submitting a similar deferral request, but has not yet deferred any CIS project operation and maintenance costs. A reserve for the carrying charges on the deferred costs after the system became operational has been recorded. Management believes no adjustment to project costs is required as of September 30, 2012.

**Environmental regulation.** HECO 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. In recent years, legislative, regulatory and governmental activities related to the environment, including proposals and rulemaking under the Clean Air Act (CAA) and Clean Water Act (CWA), have increased significantly and management anticipates that such activity will continue.

On April 20, 2011, the Federal Register published the federal Environmental Protection Agency's (EPA's) proposed regulations required by section 316(b) of the CWA designed to protect aquatic organisms from adverse impacts associated with existing power plant cooling water intake structures. The proposed regulations would apply to the cooling water systems for the steam generating units at HECO's power plants on the island of Oahu. If adopted as proposed, management believes the proposed regulations would require significant capital and annual O&M expenditures. On June 11, 2012, the EPA published additional information on the section 316(b) rule making that indicates that the EPA is considering establishing lower cost compliance alternatives in the final rule. In mid-July 2012, the EPA decided to delay issuance of the final section 316(b) rule until June 2013.

On February 16, 2012, the Federal Register published the EPA's final rule establishing the EPA's National Emission Standards for Hazardous Air Pollutants for fossil-fuel fired steam electrical generating units (EGUs). The final rule, known as the Mercury and Air Toxics Standards (MATS), applies to the 14 EGUs at HECO's power plants. MATS establishes the Maximum Achievable Control Technology standards for the control of hazardous air pollutants emissions from new and existing EGUs. Based on a review of the final rule and the benefits and costs of alternative compliance strategies, HECO has selected a MATS compliance strategy based on switching to lower emission fuels. The use of lower emission fuels will provide for MATS compliance at lower overall costs, avoid the reduction in operational flexibility imposed by emissions control equipment, achieve timely compliance with the MATS and provide flexibility for optimizing the combined compliance strategies for MATS and the tightening of the National Ambient Air Quality Standards.

On September 14, 2012, the EPA Administrator signed the final action for the Hawaii Regional Haze Federal Implementation Plan (FIP). The plan establishes an annual limit for sulfur dioxide emissions from five HELCO steam

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generating units, with compliance required commencing December 31, 2018. No specific control technologies are required for any HECO or MECO generating units. The FIP will be effective November 8, 2012.

Depending upon the final outcome of the CWA 316(b) regulations, possible changes in CWA effluent standards, the specifics of the MATS compliance plan, the tightening of the National Ambient Air Quality Standards, and the final form of the Hawaii regional haze plan, HECO and its subsidiaries may be required to incur material capital expenditures and other compliance costs, but such amounts are not determinable at this time. Additionally, the combined effects of these regulatory initiatives may result in a decision to retire certain generating units earlier than anticipated.

HECO, HELCO and MECO, like other utilities, periodically experience 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. HECO and its subsidiaries believe the costs of responding to such releases identified to date will not have a material adverse effect, individually or in the aggregate, on HECO's consolidated results of operations, financial condition or liquidity.

Former Molokai Electric Company generation site. In 1989, MECO acquired by merger Molokai Electric Company. Molokai Electric Company had sold its former generation site (Site) in 1983, but continued to operate at the Site under a lease until 1985. The EPA has since performed Brownfield assessments of the Site that identified environmental impacts in the subsurface. Although MECO never operated at the Site and operations there had stopped four years before the merger, in discussions with the EPA and the Hawaii Department of Health (DOH), MECO agreed to undertake additional investigations at the Site and an adjacent parcel that Molokai Electric Company had used for equipment storage (the Adjacent Parcel) to determine the extent of impacts of subsurface contaminants. A 2011 assessment by a MECO contractor of the Adjacent Parcel identified environmental impacts, including elevated polychlorinated biphenyls (PCBs) in the subsurface soils. In cooperation with the DOH and EPA, MECO is further investigating the Site and the Adjacent Parcel to determine the extent of impacts of PCBs, fuel oils, and other subsurface contaminants. In March 2012, MECO accrued an additional \$3.1 million (reserve balance of \$3.6 million as of September 30, 2012) for the additional investigation and estimated cleanup costs at the Site and the Adjacent Parcel; however, final costs of remediation will depend on the results of continued investigation.

Global climate change and greenhouse gas emissions reduction. National and international concern about climate change and the contribution of GHG emissions (including carbon dioxide emissions from the combustion of fossil fuels) to global warming have led to action by the State and to federal legislative and regulatory proposals to reduce GHG emissions.

In July 2007, Act 234, which requires a statewide reduction of GHG emissions by January 1, 2020 to levels at or below the statewide GHG emission levels in 1990, became law in Hawaii. The electric utilities participated in a Task Force established under Act 234, which was charged with developing a work plan and regulatory approach to reduce GHG emissions, as well as in initiatives aimed at reducing their GHG emissions, such as those being implemented under the Energy Agreement. On October 19, 2012, the DOH posted the proposed regulations required by Act 234 for public hearing and comment. In general, the proposed regulations would require affected sources that have the potential to emit GHGs in excess of established thresholds to reduce GHG emissions by 25% below 2010 emission levels by 2020. The proposed regulations also assess affected sources an annual fee based on tons per year of GHG emissions, beginning with emissions in calendar year 2012. The proposed regulations also track the federal Prevention of Significant Deterioration and Title V Greenhouse Gas Tailoring Rule (GHG Tailoring Rule, see below) and would create new thresholds for GHG emissions from new and existing stationary source facilities. Both the federal and state regulations create certain exclusions for carbon dioxide (CO<sub>2</sub>) emissions from biomass-fired and other biogenic sources. The utilities are evaluating the impact of the proposed regulations; compliance costs could be significant.

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Several approaches (e.g., cap and trade ) to GHG emission reduction have been either introduced or discussed in the U.S. Congress; however, no federal legislation has yet been enacted.

On September 22, 2009, the EPA issued its Final Mandatory Reporting of Greenhouse Gases Rule, which requires that sources emitting GHGs above certain threshold levels monitor and report GHG emissions. The utilities have submitted the required reports for 2010 and 2011 to the EPA. In December 2009, the EPA made the finding that

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motor vehicle GHG emissions endanger public health or welfare. Since then, the EPA has also issued rules that begin to address GHG emissions from stationary sources, like the utilities' generating units.

In June 2010, the EPA issued its GHG Tailoring Rule. Effective January 2, 2011, under the Prevention of Significant Deterioration program, permitting of new or modified stationary sources that have the potential to emit GHGs in greater quantities than the thresholds in the GHG Tailoring Rule will entail GHG emissions evaluation, analysis and, potentially, control requirements. In January 2011, the EPA announced that it plans to defer, for three years, GHG permitting requirements for carbon dioxide (CO<sub>2</sub>) emissions from biomass-fired and other biogenic sources. The utilities are evaluating the impact of this deferral on their generation units that are or will be fired on biofuels. On March 27, 2012, the Federal Register published the EPA's proposed New Source Performance Standard regulating carbon dioxide emissions from affected new fossil fuel-fired generating units. As proposed, the rule does not apply to non-continental units (i.e., in Hawaii and U.S. Territories) and therefore does not apply to the utilities.

HECO and its subsidiaries have taken, and continue to identify opportunities to take, direct action to reduce GHG emissions from their operations, including, but not limited to, supporting DSM programs that foster energy efficiency, using renewable resources for energy production and purchasing power from IPPs generated by renewable resources, burning renewable biodiesel in HECO's CIP CT-1, using biodiesel for startup and shutdown of selected MECO generating units, and testing biofuel blends in other HECO and MECO generating units. Management is unable to evaluate the ultimate impact on the utilities' operations of eventual comprehensive GHG regulation. However, management believes that the various initiatives it is undertaking will provide a sound basis for managing the electric utilities' carbon footprint and meeting GHG reduction goals that will ultimately emerge.

While the timing, extent and ultimate effects of climate change cannot be determined with any certainty, climate change is predicted to result in sea level rise, which could potentially impact coastal and other low-lying areas (where much of the utilities' electric infrastructure is sited), and could cause erosion of beaches, saltwater intrusion into aquifers and surface ecosystems, higher water tables and increased flooding and storm damage due to heavy rainfall. The effects of climate change on the weather (for example, floods or hurricanes), sea levels, and water availability and quality have the potential to materially adversely affect the results of operations, financial condition and liquidity of the electric utilities. For example, severe weather could cause significant harm to the electric utilities' physical facilities.

**Asset retirement obligations.** Asset retirement obligations (AROs) represent legal obligations associated with the retirement of certain tangible long-lived assets, are measured as the present value of the projected costs for the future retirement of specific assets and are recognized in the period in which the liability is incurred if a reasonable estimate of fair value can be made. HECO and its subsidiaries' recognition of AROs have no impact on their earnings. The cost of the AROs is recovered over the life of the asset through depreciation. AROs recognized by HECO and its subsidiaries relate to obligations to retire plant and equipment, including removal of asbestos and other hazardous materials.

Changes to the ARO liability included in Other liabilities on HECO's balance sheet were as follows:

| (in thousands)                    | 2012 |         | 2011 |        |
|-----------------------------------|------|---------|------|--------|
| Balance, January 1                | \$   | 50,871  | \$   | 48,630 |
| Accretion expense                 |      | 1,233   |      | 1,641  |
| Liabilities incurred              |      |         |      |        |
| Liabilities settled               |      | (2,788) |      | (681)  |
| Revisions in estimated cash flows |      |         |      | 390    |



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|                       |    |        |    |        |
|-----------------------|----|--------|----|--------|
| Balance, September 30 | \$ | 49,316 | \$ | 49,980 |
|-----------------------|----|--------|----|--------|

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**Collective bargaining agreements.** As of November 1, 2012, approximately 53% of the electric utilities employees were members of the International Brotherhood of Electrical Workers, AFL-CIO, Local 1260, which is the only union representing employees of the electric utilities. On November 1, 2012, the utilities bargaining unit employees ratified a new collective bargaining agreement and a new benefit agreement that both expire on October 31, 2018. The collective bargaining agreement provides for general non-compounded wage increases (3% for 2014, 2015, 2017 and 2018, and 3.25% for 2016). (A general 3% non-compounded wage increase will be provided to bargaining unit employees for 2013 under the collective-bargaining agreement ratified in March 2011). The agreement also includes wage adjustments for certain trades and crafts positions and different wage rates for new bargaining unit office and clerical positions. The new benefit agreement provides for an escalating percentage of employee contributions without caps for medical premiums throughout the term of the agreement.

**6 • Cash flows**

| Nine months ended September 30<br>(in millions)   | 2012  | 2011  |
|---|-------|-------|
| <b>Supplemental disclosures of cash flow information</b>                                |       |       |
| Interest paid   | \$ 40 | \$ 43 |
| Income tax paid/(refunded) (1)  | 2     | (27)  |
| <b>Supplemental disclosures of noncash activities</b>                                   |       |       |
| Additions to electric utility property, plant and equipment - Unpaid invoices and other | 27    | 21    |

(1) For the nine months ended September 30, 2012, estimated taxes paid were offset by refunds from the settlement of IRS examinations of prior years. For the nine months ended September 30, 2011, tax refunds resulted from repairs deductions and bonus depreciation taken in 2009 and 2010.

**7 • Fair value measurements**

Fair value estimates are based on the price that would be received to sell an asset, or paid upon the transfer of a liability, in an orderly transaction between market participants at the measurement date. The fair value estimates are generally determined based on assumptions that market participants would use in pricing the asset or liability and are based on market data obtained from independent sources. However, in certain cases, the electric utilities use their own assumptions about market participant assumptions based on the best information available in the circumstances. These valuations are estimates at a specific point in time, based on relevant market information, information about the financial instrument and judgments regarding future expected loss experience, economic conditions, risk characteristics of various financial instruments and other factors. These estimates do not reflect any premium or discount that could result if the electric utilities were to sell their entire holdings of a particular financial instrument at one time. Because no active trading market exists for a portion of the electric utilities financial instruments, fair value estimates cannot be determined with precision. Changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the estimates. In addition, the tax ramifications related to the realization of the unrealized gains and losses could have a significant effect on fair value estimates, but have not been considered in making such estimates.

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The Company groups its financial assets measured at fair value in three levels outlined as follows:

**Level 1:** Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

**Level 2:** Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that are derived principally from or can be corroborated by observable market data by correlation or other means.

**Level 3:** Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The electric utilities used the following methods and assumptions to estimate the fair value of each applicable class of financial instruments for which it is practicable to estimate that value:

**Cash and cash equivalents and short-term borrowings.** The carrying amount approximated fair value because of the short maturity of these instruments.

**Long-term debt.** Fair value was estimated by discounting the future cash flows using the current rates available for borrowings with similar credit terms and remaining maturities.

The estimated fair values of certain of the electric utilities' financial instruments (with the level of the fair value hierarchy in which the fair value measurements are categorized noted in parentheses) were as follows:

| (in thousands)   | September 30, 2012 |                      | December 31, 2011 |                      |
|--|--------------------|----------------------|-------------------|----------------------|
|  | Carrying amount    | Estimated fair value | Carrying amount   | Estimated fair value |
| <b>Financial assets</b>  |                    |                      |                   |                      |
| Cash and cash equivalents (Level 2)                                  | \$ 15,722          | \$ 15,722            | \$ 48,806         | \$ 48,806            |
| <b>Financial liabilities</b>   |                    |                      |                   |                      |
| Short-term borrowings - nonaffiliates (Level 2)                      | 44,719             | 44,719               |                   |                      |
| Long-term debt, net, including amounts due within one year (Level 2) | 1,147,869          | 1,178,889            | 1,058,070         | 1,095,133            |

**Fair value measurements on a nonrecurring basis.** From time to time, the utilities may be required to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or writedowns of individual assets. As of September 30, 2012, there were no adjustments to fair value for assets measured at fair value on a nonrecurring basis in accordance with GAAP.

From time to time, the utilities may be required to measure certain liabilities at fair value on a nonrecurring basis in accordance with GAAP. The fair value of the utilities ARO (Level 3) was determined by discounting the expected future cash flows using market-observable risk-free rates as adjusted by HECO's credit spread. The expected future cash flows to retire the assets are significant unobservable inputs used to measure fair value. HECO estimates these cash flows based on the cost of past asset retirements and contractor cost estimates. As of September 30, 2012, the undiscounted future cash outflows used were \$33 million. Also, see Note 5.

Table of Contents**8 • Credit agreement and changes in long-term debt**

**Credit agreement.** HECO maintains an amended revolving noncollateralized credit agreement, which established a line of credit facility of \$175 million, with a letter of credit sub-facility, expiring on December 5, 2016, with a syndicate of eight financial institutions. The credit facility will be maintained to support the issuance of commercial paper, but also may be drawn to repay HECO's short-term indebtedness, to make loans to subsidiaries and for HECO's capital expenditures, working capital and general corporate purposes.

**Changes in long-term debt.**

April 19, 2012 notes. On April 19, 2012, HECO, HELCO and MECO issued through a private placement taxable unsecured senior notes (the HECO Notes, HELCO Notes and MECO Notes, and together, the Notes) in the aggregate principal amounts of \$327 million, \$31 million and \$59 million, respectively, as follows:

(in thousands)

|                                      |    |         |
|--------------------------------------|----|---------|
| Long-term debt                       |    |         |
| HECO, 3.79%, series 2012A, due 2018  | \$ | 30,000  |
| HELCO, 3.79%, series 2012A, due 2018 |    | 11,000  |
| MECO, 3.79%, series 2012A, due 2018  |    | 9,000   |
| HECO, 4.03%, series 2012B, due 2020  |    | 62,000  |
| MECO, 4.03%, series 2012B, due 2020  |    | 20,000  |
| HECO, 4.55%, series 2012C, due 2023  |    | 50,000  |
| HELCO, 4.55%, series 2012B, due 2023 |    | 20,000  |
| MECO, 4.55%, series 2012C, due 2023  |    | 30,000  |
| HECO, 4.72%, series 2012D, due 2029  |    | 35,000  |
| HECO, 5.39%, series 2012E, due 2042  |    | 150,000 |
| Long-term debt                       | \$ | 417,000 |

All proceeds of the Notes, except the HECO Series 2012E Notes, have been applied (\$267 million in the aggregate), together with such additional funds as were required, to redeem special purpose revenue bonds (SPRBs) and refunding SPRBs issued by the Department of Budget and Finance of the State of Hawaii (DBF) for the benefit of the utilities, which outstanding bonds were in aggregate principal amount of \$271 million and had stated interest rates ranging from 5.45% to 6.20%.

September 13, 2012 notes. On September 13, 2012, HECO entered into a Note Purchase Agreement (the Note Agreement), pursuant to which HECO issued, through a private placement, its 4.53% Senior Notes, Series 2012F (to mature September 1, 2032), in the principal amount of \$40 million. The notes are unsecured and interest payable on the notes is taxable. All proceeds of the notes have been applied, together with additional funds provided by HECO, to redeem the \$40 million aggregate principal amount 5.10% Series 2002A (year of maturity 2032) SPRBs issued by the DBF for the benefit of HECO.

April 19 and September 13, 2012 notes. The note agreements contain customary representations and warranties, affirmative and negative covenants, and events of default (the occurrence of which may result in some or all of the notes becoming immediately due and payable) and

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provisions requiring the maintenance by HECO and each of HELCO and MECO of certain financial ratios generally consistent with those in HECO's existing amended revolving noncollateralized credit agreement.

All of the notes may be prepaid in whole or in part at any time at the prepayment price of the principal amount of the notes plus payment of a Make-Whole Amount. Each of the note agreements also (a) requires the utilities or HECO to offer to prepay the notes (without a Make-Whole Amount) in the event that HEI ceases to own 100% of the common stock or other securities of HECO that is ordinarily entitled, in the absence of contingencies, to vote in the election of HECO directors unless, at the time of such cessation of ownership and at all times during the period of 90 consecutive days thereafter, the long-term unsecured, unenhanced debt of HECO maintains an investment grade rating by at least one rating agency or, if more than one rating agency rates such indebtedness, then by each such rating agency, and (b) permits the utilities or HECO to offer to prepay notes (without a Make-Whole amount) in the event of a sale of assets that would otherwise constitute a covenant default.

Table of Contents**9 • Reconciliation of electric utility operating income per HEI and HECO consolidated statements of income**

| (in thousands)  | Three months ended<br>September 30 |           | Nine months ended<br>September 30 |            |
|---|------------------------------------|-----------|-----------------------------------|------------|
|   | 2012                               | 2011      | 2012                              | 2011       |
| Operating income from regulated and nonregulated activities before income taxes (per HEI consolidated statements of income) | \$ 74,819                          | \$ 74,956 | \$ 193,569                        | \$ 162,682 |
| Deduct:   |                                    |           |                                   |            |
| Income taxes on regulated activities  | (22,352)                           | (23,860)  | (58,291)                          | (46,630)   |
| Revenues from nonregulated activities   | (1,892)                            | (1,347)   | (5,431)                           | (3,467)    |
| Add: Expenses from nonregulated activities  | 804                                | 250       | 1,620                             | 673        |
| Operating income from regulated activities after income taxes (per HECO consolidated statements of income)                  | \$ 51,379                          | \$ 49,999 | \$ 131,467                        | \$ 113,258 |

**10 • Consolidating financial information**

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

HECO also unconditionally guarantees HELCO's and MECO's obligations (a) to the State of Hawaii for the repayment of principal and interest on SPRBs issued for the benefit of HELCO and MECO, (b) under their respective private placement note agreements and the HELCO Notes and MECO notes issued thereunder (see Note 8 above) and (c) relating to the trust preferred securities of Trust III (see Note 2 above). HECO is also obligated, after the satisfaction of its obligations on its own preferred stock, to make dividend, redemption and liquidation payments on HELCO's and MECO's preferred stock if the respective subsidiary is unable to make such payments.

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (Loss) (unaudited)**

Three months ended September 30, 2012

| (in thousands)  | HECO       | HELCO   | MECO    | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|---|------------|---------|---------|--------------------|---------------------------|-------------------|
| <b>Operating revenues</b>                             | \$ 579,464 | 108,490 | 111,249 |                    |                           | \$ 799,203        |
| <b>Operating expenses</b>                             |            |         |         |                    |                           |                   |
| Fuel oil  | 248,443    | 25,752  | 52,978  |                    |                           | 327,173           |
| Purchased power                                       | 135,507    | 37,693  | 13,499  |                    |                           | 186,699           |
| Other operation                                       | 48,201     | 10,888  | 11,352  |                    |                           | 70,441            |
| Maintenance   | 19,615     | 5,146   | 5,607   |                    |                           | 30,368            |
| Depreciation  | 22,738     | 8,299   | 4,904   |                    |                           | 35,941            |
| Taxes, other than income taxes                        | 53,935     | 10,444  | 10,471  |                    |                           | 74,850            |
| Income taxes  | 15,725     | 2,782   | 3,845   |                    |                           | 22,352            |
| Total operating expenses                              | 544,164    | 101,004 | 102,656 |                    |                           | 747,824           |
| <b>Operating income</b>                               | 35,300     | 7,486   | 8,593   |                    |                           | 51,379            |
| <b>Other income (loss)</b>                            |            |         |         |                    |                           |                   |
| Allowance for equity funds used during construction   | 1,323      | 148     | 140     |                    |                           | 1,611             |
| Equity in earnings of subsidiaries                    | 11,285     |         |         |                    | (11,285)                  |                   |
| Other, net  | 913        | 114     | 47      | (1)                | (28)                      | 1,045             |
| Total other income (loss)                             | 13,521     | 262     | 187     | (1)                | (11,313)                  | 2,656             |
| <b>Interest and other charges</b>                     |            |         |         |                    |                           |                   |
| Interest on long-term debt                            | 9,981      | 2,751   | 1,962   |                    |                           | 14,694            |
| Amortization of net bond premium and expense          | 629        | 117     | 124     |                    |                           | 870               |
| Other interest charges                                | 142        | 78      | 94      |                    | (28)                      | 286               |
| Allowance for borrowed funds used during construction | (576)      | (59)    | (53)    |                    |                           | (688)             |
| Total interest and other charges                      | 10,176     | 2,887   | 2,127   |                    | (28)                      | 15,162            |
| <b>Net income (loss)</b>                              | 38,645     | 4,861   | 6,653   | (1)                | (11,285)                  | 38,873            |
| Preferred stock dividend of subsidiaries              |            | 133     | 95      |                    |                           | 228               |
| <b>Net income (loss) attributable to HECO</b>         | 38,645     | 4,728   | 6,558   | (1)                | (11,285)                  | 38,645            |
| Preferred stock dividends of HECO                     | 270        |         |         |                    |                           | 270               |
| <b>Net income (loss) for common stock</b>             | \$ 38,375  | 4,728   | 6,558   | (1)                | (11,285)                  | \$ 38,375         |

Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Comprehensive Income (Loss) (unaudited)**

Three months ended September 30, 2012

| (in thousands)                                   | HECO      | HELCO | MECO  | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|--|-----------|-------|-------|--------------------|---------------------------|-------------------|
| Net income (loss) for common stock               | \$ 38,375 | 4,728 | 6,558 | (1)                | (11,285)                  | \$ 38,375         |
| Other comprehensive income (loss), net of taxes: |           |       |       |                    |                           |                   |



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Retirement benefit plans:

|   |           |       |       |       |          |           |
|---|-----------|-------|-------|-------|----------|-----------|
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of tax benefits | 3,419     | 526   | 443   | (969) | 3,419    |           |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory assets, net of taxes                             | (3,342)   | (521) | (436) | 957   | (3,342)  |           |
| Other comprehensive income (loss), net of taxes   | 77        | 5     | 7     | (12)  | 77       |           |
| Comprehensive income (loss) attributable to common shareholder  | \$ 38,452 | 4,733 | 6,565 | (1)   | (11,297) | \$ 38,452 |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (Loss) (unaudited)**

Three months ended September 30, 2011

| (in thousands)  | HECO       | HELCO   | MECO    | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|---|------------|---------|---------|--------------------|---------------------------|-------------------|
| <b>Operating revenues</b>                             | \$ 590,014 | 118,420 | 110,473 |                    |                           | \$ 818,907        |
| <b>Operating expenses</b>                             |            |         |         |                    |                           |                   |
| Fuel oil  | 259,027    | 31,433  | 62,015  |                    |                           | 352,475           |
| Purchased power                                       | 141,742    | 38,252  | 8,490   |                    |                           | 188,484           |
| Other operation                                       | 43,604     | 8,530   | 9,281   |                    |                           | 61,415            |
| Maintenance   | 20,776     | 5,115   | 6,445   |                    |                           | 32,336            |
| Depreciation  | 21,613     | 8,148   | 5,222   |                    |                           | 34,983            |
| Taxes, other than income taxes                        | 54,052     | 10,929  | 10,374  |                    |                           | 75,355            |
| Income taxes  | 16,341     | 4,988   | 2,531   |                    |                           | 23,860            |
| Total operating expenses                              | 557,155    | 107,395 | 104,358 |                    |                           | 768,908           |
| <b>Operating income</b>                               | 32,859     | 11,025  | 6,115   |                    |                           | 49,999            |
| <b>Other income (loss)</b>                            |            |         |         |                    |                           |                   |
| Allowance for equity funds used during construction   | 1,220      | 131     | 219     |                    |                           | 1,570             |
| Equity in earnings of subsidiaries                    | 11,929     |         |         |                    | (11,929)                  |                   |
| Other, net  | 930        | 130     | 116     | (2)                | (4)                       | 1,170             |
| Total other income (loss)                             | 14,079     | 261     | 335     | (2)                | (11,933)                  | 2,740             |
| <b>Interest and other charges</b>                     |            |         |         |                    |                           |                   |
| Interest on long-term debt                            | 9,130      | 2,985   | 2,268   |                    |                           | 14,383            |
| Amortization of net bond premium and expense          | 503        | 137     | 127     |                    |                           | 767               |
| Other interest charges                                | (406)      | 97      | 103     |                    | (4)                       | (210)             |
| Allowance for borrowed funds used during construction | (518)      | (54)    | (86)    |                    |                           | (658)             |
| Total interest and other charges                      | 8,709      | 3,165   | 2,412   |                    | (4)                       | 14,282            |
| <b>Net income (loss)</b>                              | 38,229     | 8,121   | 4,038   | (2)                | (11,929)                  | 38,457            |
| Preferred stock dividend of subsidiaries              |            | 133     | 95      |                    |                           | 228               |
| <b>Net income (loss) attributable to HECO</b>         | 38,229     | 7,988   | 3,943   | (2)                | (11,929)                  | 38,229            |
| Preferred stock dividends of HECO                     | 270        |         |         |                    |                           | 270               |
| <b>Net income (loss) for common stock</b>             | \$ 37,959  | 7,988   | 3,943   | (2)                | (11,929)                  | \$ 37,959         |

Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Comprehensive Income (Loss) (unaudited)**

Three months ended September 30, 2011

| (in thousands)                     | HECO      | HELCO | MECO  | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|------------------------------------|-----------|-------|-------|--------------------|---------------------------|-------------------|
| Net income (loss) for common stock | \$ 37,959 | 7,988 | 3,943 | (2)                | (11,929)                  | \$ 37,959         |

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Other comprehensive income (loss), net of taxes:

Retirement benefit plans:

|   |           |       |       |              |           |
|---|-----------|-------|-------|--------------|-----------|
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of tax benefits | 1,854     | 296   | 301   | (597)        | 1,854     |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory assets, net of taxes                             | (1,732)   | (285) | (281) | 566          | (1,732)   |
| Other comprehensive income (loss), net of taxes   | 122       | 11    | 20    | (31)         | 122       |
| Comprehensive income (loss) attributable to common shareholder  | \$ 38,081 | 7,999 | 3,963 | (2) (11,960) | \$ 38,081 |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (Loss) (unaudited)**

Nine months ended September 30, 2012

| (in thousands)  | HECO         | HELCO   | MECO    | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|---|--------------|---------|---------|--------------------|---------------------------|-------------------|
| <b>Operating revenues</b>                             | \$ 1,677,604 | 332,558 | 324,664 |                    |                           | \$ 2,334,826      |
| <b>Operating expenses</b>                             |              |         |         |                    |                           |                   |
| Fuel oil  | 724,862      | 88,778  | 172,436 |                    |                           | 986,076           |
| Purchased power                                       | 401,423      | 108,996 | 29,421  |                    |                           | 539,840           |
| Other operation                                       | 132,770      | 29,851  | 34,185  |                    |                           | 196,806           |
| Maintenance   | 60,993       | 14,280  | 16,368  |                    |                           | 91,641            |
| Depreciation  | 68,046       | 25,036  | 15,474  |                    |                           | 108,556           |
| Taxes, other than income taxes                        | 159,928      | 31,330  | 30,891  |                    |                           | 222,149           |
| Income taxes  | 41,049       | 9,836   | 7,406   |                    |                           | 58,291            |
| Total operating expenses                              | 1,589,071    | 308,107 | 306,181 |                    |                           | 2,203,359         |
| <b>Operating income</b>                               | 88,533       | 24,451  | 18,483  |                    |                           | 131,467           |
| <b>Other income (loss)</b>                            |              |         |         |                    |                           |                   |
| Allowance for equity funds used during construction   | 4,558        | 433     | 557     |                    |                           | 5,548             |
| Equity in earnings of subsidiaries                    | 28,025       |         |         |                    | (28,025)                  |                   |
| Other, net  | 3,114        | 314     | 304     | (3)                | (56)                      | 3,673             |
| Total other income (loss)                             | 35,697       | 747     | 861     | (3)                | (28,081)                  | 9,221             |
| <b>Interest and other charges</b>                     |              |         |         |                    |                           |                   |
| Interest on long-term debt                            | 29,301       | 8,649   | 6,450   |                    |                           | 44,400            |
| Amortization of net bond premium and expense          | 1,541        | 362     | 373     |                    |                           | 2,276             |
| Other interest charges                                | (412)        | 131     | 253     |                    | (56)                      | (84)              |
| Allowance for borrowed funds used during construction | (2,061)      | (174)   | (216)   |                    |                           | (2,451)           |
| Total interest and other charges                      | 28,369       | 8,968   | 6,860   |                    | (56)                      | 44,141            |
| <b>Net income (loss)</b>                              | 95,861       | 16,230  | 12,484  | (3)                | (28,025)                  | 96,547            |
| Preferred stock dividend of subsidiaries              |              | 400     | 286     |                    |                           | 686               |
| <b>Net income (loss) attributable to HECO</b>         | 95,861       | 15,830  | 12,198  | (3)                | (28,025)                  | 95,861            |
| Preferred stock dividends of HECO                     | 810          |         |         |                    |                           | 810               |
| <b>Net income (loss) for common stock</b>             | \$ 95,051    | 15,830  | 12,198  | (3)                | (28,025)                  | \$ 95,051         |

Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Comprehensive Income (Loss) (unaudited)**

Nine months ended September 30, 2012

| (in thousands)                     | HECO      | HELCO  | MECO   | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|------------------------------------|-----------|--------|--------|--------------------|---------------------------|-------------------|
| Net income (loss) for common stock | \$ 95,051 | 15,830 | 12,198 | (3)                | (28,025)                  | \$ 95,051         |

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Other comprehensive income (loss), net of taxes:

Retirement benefit plans:

|   |           |         |         |              |           |
|---|-----------|---------|---------|--------------|-----------|
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of tax benefits | 10,255    | 1,576   | 1,328   | (2,904)      | 10,255    |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory assets, net of taxes                             | (10,026)  | (1,558) | (1,309) | 2,867        | (10,026)  |
| Other comprehensive income (loss), net of taxes   | 229       | 18      | 19      | (37)         | 229       |
| Comprehensive income (loss) attributable to common shareholder  | \$ 95,280 | 15,848  | 12,217  | (3) (28,062) | \$ 95,280 |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Income (Loss) (unaudited)**

Nine months ended September 30, 2011

| (in thousands)  | HECO         | HELCO   | MECO    | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|---|--------------|---------|---------|--------------------|---------------------------|-------------------|
| <b>Operating revenues</b>                             | \$ 1,550,491 | 328,650 | 311,719 |                    |                           | \$ 2,190,860      |
| <b>Operating expenses</b>                             |              |         |         |                    |                           |                   |
| Fuel oil  | 662,524      | 90,047  | 172,905 |                    |                           | 925,476           |
| Purchased power                                       | 386,414      | 100,516 | 21,249  |                    |                           | 508,179           |
| Other operation                                       | 139,255      | 26,322  | 28,757  |                    |                           | 194,334           |
| Maintenance   | 64,045       | 13,263  | 15,500  |                    |                           | 92,808            |
| Depreciation  | 67,381       | 24,619  | 15,673  |                    |                           | 107,673           |
| Taxes, other than income taxes                        | 143,049      | 30,265  | 29,188  |                    |                           | 202,502           |
| Income taxes  | 24,679       | 13,482  | 8,469   |                    |                           | 46,630            |
| Total operating expenses                              | 1,487,347    | 298,514 | 291,741 |                    |                           | 2,077,602         |
| <b>Operating income</b>                               | 63,144       | 30,136  | 19,978  |                    |                           | 113,258           |
| <b>Other income (loss)</b>                            |              |         |         |                    |                           |                   |
| Allowance for equity funds used during construction   | 3,154        | 447     | 530     |                    |                           | 4,131             |
| Equity in earnings of subsidiaries                    | 34,382       |         |         |                    | (34,382)                  |                   |
| Other, net  | 2,288        | 450     | 270     | (8)                | (22)                      | 2,978             |
| Total other income (loss)                             | 39,824       | 897     | 800     | (8)                | (34,404)                  | 7,109             |
| <b>Interest and other charges</b>                     |              |         |         |                    |                           |                   |
| Interest on long-term debt                            | 27,391       | 8,954   | 6,804   |                    |                           | 43,149            |
| Amortization of net bond premium and expense          | 1,519        | 417     | 380     |                    |                           | 2,316             |
| Other interest charges                                | 414          | 271     | 302     |                    | (22)                      | 965               |
| Allowance for borrowed funds used during construction | (1,338)      | (189)   | (204)   |                    |                           | (1,731)           |
| Total interest and other charges                      | 27,986       | 9,453   | 7,282   |                    | (22)                      | 44,699            |
| <b>Net income (loss)</b>                              | 74,982       | 21,580  | 13,496  | (8)                | (34,382)                  | 75,668            |
| Preferred stock dividend of subsidiaries              |              | 400     | 286     |                    |                           | 686               |
| <b>Net income (loss) attributable to HECO</b>         | 74,982       | 21,180  | 13,210  | (8)                | (34,382)                  | 74,982            |
| Preferred stock dividends of HECO                     | 810          |         |         |                    |                           | 810               |
| <b>Net income (loss) for common stock</b>             | \$ 74,172    | 21,180  | 13,210  | (8)                | (34,382)                  | \$ 74,172         |

Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Comprehensive Income (Loss) (unaudited)**

Nine months ended September 30, 2011

| (in thousands)                     | HECO      | HELCO  | MECO   | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|------------------------------------|-----------|--------|--------|--------------------|---------------------------|-------------------|
| Net income (loss) for common stock | \$ 74,172 | 21,180 | 13,210 | (8)                | (34,382)                  | \$ 74,172         |

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Other comprehensive income (loss), net of taxes:

Retirement benefit plans:

|   |           |        |        |         |                    |
|---|-----------|--------|--------|---------|--------------------|
| Less: amortization of net loss, prior service gain and transition obligation included in net periodic benefit cost, net of tax benefits | 6,280     | 992    | 868    | (1,860) | 6,280              |
| Less: reclassification adjustment for impact of D&Os of the PUC included in regulatory assets, net of taxes                             | (6,084)   | (980)  | (849)  | 1,829   | (6,084)            |
| Other comprehensive income (loss), net of taxes   | 196       | 12     | 19     | (31)    | 196                |
| Comprehensive income (loss) attributable to common shareholder  | \$ 74,368 | 21,192 | 13,229 | (8)     | (34,413) \$ 74,368 |

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

**Consolidating Balance Sheet (unaudited)**

September 30, 2012

| (in thousands)   | HECO                | HELCO          | MECO           | Other subsidiaries | Consolidating adjustments | HECO Consolidated   |
|--|---------------------|----------------|----------------|--------------------|---------------------------|---------------------|
| <b>Assets</b>  |                     |                |                |                    |                           |                     |
| <b>Utility plant, at cost</b>                                  |                     |                |                |                    |                           |                     |
| Land   | \$ 43,347           | 5,182          | 3,015          |                    |                           | \$ 51,544           |
| Plant and equipment  | 3,244,892           | 1,066,465      | 934,412        |                    |                           | 5,245,769           |
| Less accumulated depreciation                                  | (1,172,560)         | (431,229)      | (422,661)      |                    |                           | (2,026,450)         |
| Construction in progress                                       | 146,571             | 15,963         | 13,682         |                    |                           | 176,216             |
| <b>Net utility plant</b>                                       | <b>2,262,250</b>    | <b>656,381</b> | <b>528,448</b> |                    |                           | <b>3,447,079</b>    |
| <b>Investment in wholly owned subsidiaries, at equity</b>      | <b>527,791</b>      |                |                |                    | <b>(527,791)</b>          |                     |
| <b>Current assets</b>  |                     |                |                |                    |                           |                     |
| Cash and cash equivalents                                      | 6,982               | 5,226          | 3,409          | 105                |                           | 15,722              |
| Advances to affiliates   |                     | 29,400         | 7,000          |                    | (36,400)                  |                     |
| Customer accounts receivable, net                              | 166,597             | 35,074         | 25,262         |                    |                           | 226,933             |
| Accrued unbilled revenues, net                                 | 99,901              | 15,392         | 16,797         |                    |                           | 132,090             |
| Other accounts receivable, net                                 | 15,864              | 1,950          | 995            |                    | (16,884)                  | 1,925               |
| Fuel oil stock, at average cost                                | 164,402             | 16,054         | 22,464         |                    |                           | 202,920             |
| Materials and supplies, at average cost                        | 31,416              | 5,419          | 13,658         |                    |                           | 50,493              |
| Prepayments and other  | 47,458              | 7,314          | 9,234          |                    |                           | 64,006              |
| Regulatory assets  | 22,693              | 1,236          | 1,174          |                    |                           | 25,103              |
| <b>Total current assets</b>                                    | <b>555,313</b>      | <b>117,065</b> | <b>99,993</b>  | <b>105</b>         | <b>(53,284)</b>           | <b>719,192</b>      |
| <b>Other long-term assets</b>                                  |                     |                |                |                    |                           |                     |
| Regulatory assets  | 512,576             | 89,736         | 88,579         |                    |                           | 690,891             |
| Unamortized debt expense                                       | 7,227               | 2,100          | 1,459          |                    |                           | 10,786              |
| Other  | 60,361              | 14,645         | 18,761         |                    |                           | 93,767              |
| <b>Total other long-term assets</b>                            | <b>580,164</b>      | <b>106,481</b> | <b>108,799</b> |                    |                           | <b>795,444</b>      |
| <b>Total assets</b>  | <b>\$ 3,925,518</b> | <b>879,927</b> | <b>737,240</b> | <b>105</b>         | <b>(581,075)</b>          | <b>\$ 4,961,715</b> |
| <b>Capitalization and liabilities</b>                          |                     |                |                |                    |                           |                     |
| <b>Capitalization</b>  |                     |                |                |                    |                           |                     |
| Common stock equity  | \$ 1,443,338        | 286,462        | 241,225        | 104                | (527,791)                 | \$ 1,443,338        |
| Cumulative preferred stock not subject to mandatory redemption | 22,293              | 7,000          | 5,000          |                    |                           | 34,293              |
| Long-term debt, net  | 780,546             | 201,323        | 166,000        |                    |                           | 1,147,869           |
| <b>Total capitalization</b>                                    | <b>2,246,177</b>    | <b>494,785</b> | <b>412,225</b> | <b>104</b>         | <b>(527,791)</b>          | <b>2,625,500</b>    |
| <b>Current liabilities</b>                                     |                     |                |                |                    |                           |                     |
| Short-term borrowings-nonaffiliate                             | 44,719              |                |                |                    |                           | 44,719              |
| Short-term borrowings-affiliate                                | 36,400              |                |                |                    | (36,400)                  |                     |
| Accounts payable   | 170,792             | 23,283         | 17,924         |                    |                           | 211,999             |
| Interest and preferred dividends payable                       | 15,122              | 3,809          | 3,533          |                    | (6)                       | 22,458              |
| Taxes accrued  | 164,498             | 36,720         | 34,084         |                    |                           | 235,302             |
| Other  | 46,868              | 15,135         | 17,458         | 1                  | (16,878)                  | 62,584              |
| <b>Total current liabilities</b>                               | <b>478,399</b>      | <b>78,947</b>  | <b>72,999</b>  | <b>1</b>           | <b>(53,284)</b>           | <b>577,062</b>      |
| <b>Deferred credits and other liabilities</b>                  |                     |                |                |                    |                           |                     |
| Deferred income taxes  | 301,803             | 69,344         | 49,577         |                    |                           | 420,724             |
| Regulatory liabilities   | 216,284             | 66,077         | 36,969         |                    |                           | 319,330             |
| Unamortized tax credits  | 38,091              | 13,190         | 12,897         |                    |                           | 64,178              |
| Retirement benefits liability                                  | 345,537             | 57,390         | 60,672         |                    |                           | 463,599             |



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|   |              |         |         |     |           |              |
|---|--------------|---------|---------|-----|-----------|--------------|
| Other   | 69,109       | 20,334  | 14,016  |     |           | 103,459      |
| <b>Total deferred credits and other liabilities</b> | 970,824      | 226,335 | 174,131 |     |           | 1,371,290    |
| Contributions in aid of construction                | 230,118      | 79,860  | 77,885  |     |           | 387,863      |
| <b>Total capitalization and liabilities</b>         | \$ 3,925,518 | 879,927 | 737,240 | 105 | (581,075) | \$ 4,961,715 |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Balance Sheet (unaudited)**

December 31, 2011

| (in thousands)   | HECO                | HELCO          | MECO           | Other subsidiaries | Consolidating adjustments | HECO Consolidated   |
|--|---------------------|----------------|----------------|--------------------|---------------------------|---------------------|
| <b>Assets</b>  |                     |                |                |                    |                           |                     |
| <b>Utility plant, at cost</b>                                  |                     |                |                |                    |                           |                     |
| Land   | \$ 43,316           | 5,182          | 3,016          |                    |                           | \$ 51,514           |
| Plant and equipment  | 3,091,908           | 1,048,599      | 911,520        |                    |                           | 5,052,027           |
| Less accumulated depreciation                                  | (1,141,839)         | (414,769)      | (410,286)      |                    |                           | (1,966,894)         |
| Construction in progress                                       | 117,625             | 8,144          | 13,069         |                    |                           | 138,838             |
| <b>Net utility plant</b>                                       | <b>2,111,010</b>    | <b>647,156</b> | <b>517,319</b> |                    |                           | <b>3,275,485</b>    |
| <b>Investment in wholly owned subsidiaries, at equity</b>      | <b>516,143</b>      |                |                |                    | <b>(516,143)</b>          |                     |
| <b>Current assets</b>  |                     |                |                |                    |                           |                     |
| Cash and cash equivalents                                      | 44,819              | 3,383          | 496            | 108                |                           | 48,806              |
| Advances to affiliates   |                     | 46,150         | 18,500         |                    | (64,650)                  |                     |
| Customer accounts receivable, net                              | 130,190             | 28,602         | 24,536         |                    |                           | 183,328             |
| Accrued unbilled revenues, net                                 | 103,328             | 18,499         | 15,999         |                    |                           | 137,826             |
| Other accounts receivable, net                                 | 8,987               | 1,186          | 3,008          |                    | (4,558)                   | 8,623               |
| Fuel oil stock, at average cost                                | 128,037             | 19,217         | 24,294         |                    |                           | 171,548             |
| Materials and supplies, at average cost                        | 25,096              | 4,700          | 13,392         |                    |                           | 43,188              |
| Prepayments and other  | 22,517              | 6,948          | 7,343          |                    | (141)                     | 36,667              |
| Regulatory assets  | 18,038              | 1,115          | 1,130          |                    |                           | 20,283              |
| <b>Total current assets</b>                                    | <b>481,012</b>      | <b>129,800</b> | <b>108,698</b> | <b>108</b>         | <b>(69,349)</b>           | <b>650,269</b>      |
| <b>Other long-term assets</b>                                  |                     |                |                |                    |                           |                     |
| Regulatory assets  | 478,851             | 86,394         | 83,861         |                    |                           | 649,106             |
| Unamortized debt expense                                       | 8,446               | 2,464          | 1,876          |                    |                           | 12,786              |
| Other  | 58,672              | 11,843         | 15,846         |                    |                           | 86,361              |
| <b>Total other long-term assets</b>                            | <b>545,969</b>      | <b>100,701</b> | <b>101,583</b> |                    |                           | <b>748,253</b>      |
| <b>Total assets</b>  | <b>\$ 3,654,134</b> | <b>877,657</b> | <b>727,600</b> | <b>108</b>         | <b>(585,492)</b>          | <b>\$ 4,674,007</b> |
| <b>Capitalization and liabilities</b>                          |                     |                |                |                    |                           |                     |
| <b>Capitalization</b>  |                     |                |                |                    |                           |                     |
| Common stock equity  | \$ 1,402,841        | 280,468        | 235,568        | 107                | (516,143)                 | \$ 1,402,841        |
| Cumulative preferred stock not subject to mandatory redemption | 22,293              | 7,000          | 5,000          |                    |                           | 34,293              |
| Long-term debt, net  | 629,757             | 204,110        | 166,703        |                    |                           | 1,000,570           |
| <b>Total capitalization</b>                                    | <b>2,054,891</b>    | <b>491,578</b> | <b>407,271</b> | <b>107</b>         | <b>(516,143)</b>          | <b>2,437,704</b>    |
| <b>Current liabilities</b>                                     |                     |                |                |                    |                           |                     |
| Current portion of long-term debt                              | 42,580              | 7,200          | 7,720          |                    |                           | 57,500              |
| Short-term borrowings-affiliate                                | 64,650              |                |                |                    | (64,650)                  |                     |
| Accounts payable   | 140,044             | 29,616         | 18,920         |                    |                           | 188,580             |
| Interest and preferred dividends payable                       | 12,648              | 4,074          | 2,762          |                    | (1)                       | 19,483              |
| Taxes accrued  | 155,867             | 38,598         | 35,752         |                    | (141)                     | 230,076             |
| Other  | 50,828              | 9,478          | 13,603         | 1                  | (4,557)                   | 69,353              |
| <b>Total current liabilities</b>                               | <b>466,617</b>      | <b>88,966</b>  | <b>78,757</b>  | <b>1</b>           | <b>(69,349)</b>           | <b>564,992</b>      |
| <b>Deferred credits and other liabilities</b>                  |                     |                |                |                    |                           |                     |
| Deferred income taxes  | 236,890             | 61,044         | 39,929         |                    |                           | 337,863             |
| Regulatory liabilities   | 215,401             | 62,049         | 38,016         |                    |                           | 315,466             |
| Unamortized tax credits  | 34,877              | 12,951         | 12,786         |                    |                           | 60,614              |
| Retirement benefits liability                                  | 368,245             | 62,036         | 64,840         |                    |                           | 495,121             |

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|   |              |         |         |     |           |              |
|---|--------------|---------|---------|-----|-----------|--------------|
| Other   | 72,418       | 22,391  | 11,235  |     |           | 106,044      |
| <b>Total deferred credits and other liabilities</b> | 927,831      | 220,471 | 166,806 |     |           | 1,315,108    |
| Contributions in aid of construction                | 204,795      | 76,642  | 74,766  |     |           | 356,203      |
| <b>Total capitalization and liabilities</b>         | \$ 3,654,134 | 877,657 | 727,600 | 108 | (585,492) | \$ 4,674,007 |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Changes in Common Stock Equity (unaudited)**

Nine months ended September 30, 2012

| (in thousands)                           | HECO         | HELCO   | MECO    | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|--|--------------|---------|---------|--------------------|---------------------------|-------------------|
| <b>Balance, December 31, 2011</b>        | \$ 1,402,841 | 280,468 | 235,568 | 107                | (516,143)                 | \$ 1,402,841      |
| Net income (loss) for common stock       | 95,051       | 15,830  | 12,198  | (3)                | (28,025)                  | 95,051            |
| Other comprehensive income, net of taxes | 229          | 18      | 19      |                    | (37)                      | 229               |
| Common stock dividends                   | (54,783)     | (9,854) | (6,560) |                    | 16,414                    | (54,783)          |
| <b>Balance, September 30, 2012</b>       | \$ 1,443,338 | 286,462 | 241,225 | 104                | (527,791)                 | \$ 1,443,338      |

Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Changes in Common Stock Equity (unaudited)**

Nine months ended September 30, 2011

| (in thousands)                           | HECO         | HELCO    | MECO    | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|--|--------------|----------|---------|--------------------|---------------------------|-------------------|
| <b>Balance, December 31, 2010</b>        | \$ 1,334,155 | 269,986  | 229,651 | 91                 | (499,728)                 | \$ 1,334,155      |
| Net income (loss) for common stock       | 74,172       | 21,180   | 13,210  | (8)                | (34,382)                  | 74,172            |
| Other comprehensive income, net of taxes | 196          | 12       | 19      |                    | (31)                      | 196               |
| Common stock dividends                   | (52,919)     | (12,093) | (9,003) |                    | 21,096                    | (52,919)          |
| Capital contribution from parent         |              |          |         | 25                 | (25)                      |                   |
| <b>Balance, September 30, 2011</b>       | \$ 1,355,604 | 279,085  | 233,877 | 108                | (513,070)                 | \$ 1,355,604      |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Cash Flows (unaudited)**

Nine months ended September 30, 2012

| (in thousands)   | HECO      | HELCO    | MECO     | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|--|-----------|----------|----------|--------------------|---------------------------|-------------------|
| <b>Cash flows from operating activities:</b>   |           |          |          |                    |                           |                   |
| Net income (loss)  | \$ 95,861 | 16,230   | 12,484   | (3)                | (28,025)                  | \$ 96,547         |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:                 |           |          |          |                    |                           |                   |
| Equity in earnings of subsidiaries   | (28,100)  |          |          |                    | 28,025                    | (75)              |
| Common stock dividends received from subsidiaries  | 16,464    |          |          |                    | (16,414)                  | 50                |
| Depreciation of property, plant and equipment  | 68,046    | 25,036   | 15,474   |                    |                           | 108,556           |
| Other amortization   | 691       | 1,776    | 1,607    |                    |                           | 4,074             |
| Change in deferred income taxes  | 64,790    | 8,290    | 9,637    |                    |                           | 82,717            |
| Change in tax credits, net   | 3,256     | 256      | 130      |                    |                           | 3,642             |
| Allowance for equity funds used during construction  | (4,558)   | (433)    | (557)    |                    |                           | (5,548)           |
| Changes in assets and liabilities:   |           |          |          |                    |                           |                   |
| Decrease (increase) in accounts receivable   | (43,284)  | (7,236)  | 1,287    |                    | 12,326                    | (36,907)          |
| Decrease (increase) in accrued unbilled revenues   | 3,427     | 3,107    | (798)    |                    |                           | 5,736             |
| Decrease (increase) in fuel oil stock  | (36,365)  | 3,163    | 1,830    |                    |                           | (31,372)          |
| Increase in materials and supplies   | (6,320)   | (719)    | (266)    |                    |                           | (7,305)           |
| Increase in regulatory assets  | (44,175)  | (6,621)  | (6,997)  |                    |                           | (57,793)          |
| Increase (decrease) in accounts payable  | 7,872     | (8,518)  | (2,835)  |                    |                           | (3,481)           |
| Change in prepaid and accrued income and utility revenue taxes   | (14,006)  | (3,562)  | (3,097)  |                    |                           | (20,665)          |
| Contributions to defined benefit pension and other postretirement benefit plans                                    | (45,878)  | (8,270)  | (8,269)  |                    |                           | (62,417)          |
| Change in other assets and liabilities   | 5,451     | 5,013    | 6,115    |                    | (12,326)                  | 4,253             |
| Net cash provided by (used in) operating activities  | 43,172    | 27,512   | 25,745   | (3)                | (16,414)                  | 80,012            |
| <b>Cash flows from investing activities:</b>   |           |          |          |                    |                           |                   |
| Capital expenditures   | (172,872) | (26,331) | (21,767) |                    |                           | (220,970)         |
| Contributions in aid of construction   | 25,547    | 4,199    | 3,360    |                    |                           | 33,106            |
| Advances from (to) affiliates  |           | 16,750   | 11,500   |                    | (28,250)                  |                   |
| Net cash used in investing activities  | (147,325) | (5,382)  | (6,907)  |                    | (28,250)                  | (187,864)         |
| <b>Cash flows from financing activities:</b>   |           |          |          |                    |                           |                   |
| Common stock dividends   | (54,783)  | (9,854)  | (6,560)  |                    | 16,414                    | (54,783)          |
| Preferred stock dividends of HECO and subsidiaries   | (810)     | (400)    | (286)    |                    |                           | (1,496)           |
| Proceeds from issuance of long-term debt   | 367,000   | 31,000   | 59,000   |                    |                           | 457,000           |
| Repayment of long-term debt  | (259,580) | (41,200) | (67,720) |                    |                           | (368,500)         |
| Net increase in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or | 16,469    |          |          |                    | 28,250                    | 44,719            |

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|  |          |          |          |     |        |           |
|--|----------|----------|----------|-----|--------|-----------|
| less   |          |          |          |     |        |           |
| Other  | (1,980)  | 167      | (359)    |     |        | (2,172)   |
| Net cash provided by (used in) financing activities  | 66,316   | (20,287) | (15,925) |     | 44,664 | 74,768    |
| Net increase (decrease) in cash and cash equivalents | (37,837) | 1,843    | 2,913    | (3) |        | (33,084)  |
| Cash and cash equivalents, beginning of period       | 44,819   | 3,383    | 496      | 108 |        | 48,806    |
| Cash and cash equivalents, end of period             | \$ 6,982 | 5,226    | 3,409    | 105 |        | \$ 15,722 |

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Hawaiian Electric Company, Inc. and Subsidiaries

**Consolidating Statement of Cash Flows (unaudited)**

Nine months ended September 30, 2011

| (in thousands)  | HECO      | HELCO    | MECO     | Other subsidiaries | Consolidating adjustments | HECO Consolidated |
|---|-----------|----------|----------|--------------------|---------------------------|-------------------|
| <b>Cash flows from operating activities:</b>  |           |          |          |                    |                           |                   |
| Net income (loss)   | \$ 74,982 | 21,580   | 13,496   | (8)                | (34,382)                  | \$ 75,668         |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:                      |           |          |          |                    |                           |                   |
| Equity in earnings of subsidiaries  | (34,457)  |          |          |                    | 34,382                    | (75)              |
| Common stock dividends received from subsidiaries   | 21,171    |          |          |                    | (21,096)                  | 75                |
| Depreciation of property, plant and equipment   | 67,381    | 24,619   | 15,673   |                    |                           | 107,673           |
| Other amortization  | 9,390     | 1,928    | 1,376    |                    |                           | 12,694            |
| Change in deferred income taxes   | 33,606    | 9,801    | 7,713    |                    |                           | 51,120            |
| Change in tax credits, net  | 771       | 510      | 135      |                    |                           | 1,416             |
| Allowance for equity funds used during construction   | (3,154)   | (447)    | (530)    |                    |                           | (4,131)           |
| Change in cash overdraft  |           | (2,527)  | (161)    |                    |                           | (2,688)           |
| Changes in assets and liabilities:  |           |          |          |                    |                           |                   |
| Increase in accounts receivable   | (33,705)  | (3,600)  | (5,926)  |                    | 265                       | (42,966)          |
| Decrease (increase) in accrued unbilled revenues  | (32,482)  | (1,719)  | 698      |                    |                           | (33,503)          |
| Decrease (increase) in fuel oil stock   | 7,631     | (4,691)  | (7,532)  |                    |                           | (4,592)           |
| Increase in materials and supplies  | (4,640)   | (86)     | (554)    |                    |                           | (5,280)           |
| Increase in regulatory assets   | (27,602)  | (1,551)  | (5,078)  |                    |                           | (34,231)          |
| Increase (decrease) in accounts payable   | (52,693)  | 100      | (6,933)  |                    |                           | (59,526)          |
| Change in prepaid and accrued income and utility revenue taxes  | 25,633    | 8,760    | 10,105   |                    |                           | 44,498            |
| Contributions to defined benefit pension and other postretirement benefit plans   | (40,944)  | (6,914)  | (7,377)  |                    |                           | (55,235)          |
| Change in other assets and liabilities  | 5,582     | 1,429    | 2,807    | (2)                | (265)                     | 9,551             |
| Net cash provided by (used in) operating activities   | 16,470    | 47,192   | 17,912   | (10)               | (21,096)                  | 60,468            |
| <b>Cash flows from investing activities:</b>  |           |          |          |                    |                           |                   |
| Capital expenditures  | (100,033) | (22,770) | (19,931) |                    |                           | (142,734)         |
| Contributions in aid of construction  | 9,381     | 3,884    | 1,841    |                    |                           | 15,106            |
| Other   | 77        |          |          |                    |                           | 77                |
| Investment in consolidated subsidiary   | (25)      |          |          |                    | 25                        |                   |
| Advances from (to) affiliates   |           | (13,750) | 10,500   |                    | 3,250                     |                   |
| Net cash used in investing activities   | (90,600)  | (32,636) | (7,590)  |                    | 3,275                     | (127,551)         |
| <b>Cash flows from financing activities:</b>  |           |          |          |                    |                           |                   |
| Common stock dividends  | (52,919)  | (12,093) | (9,003)  |                    | 21,096                    | (52,919)          |
| Preferred stock dividends of HECO and subsidiaries  | (810)     | (400)    | (286)    |                    |                           | (1,496)           |
| Net increase in short-term borrowings from nonaffiliates and affiliate with original maturities of three months or less | 15,748    |          |          |                    | (3,250)                   | 12,498            |

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|  |           |          |         |     |        |           |
|--|-----------|----------|---------|-----|--------|-----------|
| Proceeds from issuance of common stock               |           |          |         | 25  | (25)   |           |
| Other  | (61)      |          | (6)     |     |        | (67)      |
| Net cash provided by (used in) financing activities  | (38,042)  | (12,493) | (9,295) | 25  | 17,821 | (41,984)  |
| Net increase (decrease) in cash and cash equivalents | (112,172) | 2,063    | 1,027   | 15  |        | (109,067) |
| Cash and cash equivalents, beginning of period       | 121,019   | 1,229    | 594     | 94  |        | 122,936   |
| Cash and cash equivalents, end of period             | \$ 8,847  | 3,292    | 1,621   | 109 |        | \$ 13,869 |



Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion updates Management's Discussion and Analysis of Financial Condition and Results of Operations included in HEI's and HECO's Form 10-K for 2011 and should be read in conjunction with the 2011 annual consolidated financial statements of HEI and HECO and notes thereto included and incorporated by reference, respectively, in HEI's and HECO's Form 10-K for 2011, as well as the quarterly (as of and for the three and nine months ended September 30, 2012) financial statements and notes thereto included in this Form 10-Q.

**HEI Consolidated****RESULTS OF OPERATIONS**

| (in thousands, except per share amounts)             | Three months ended<br>September 30 |              | %<br>change | Primary reason(s) for<br>significant change*   |
|--|------------------------------------|--------------|-------------|--|
|  | 2012                               | 2011         |             |  |
| Revenues   | \$ 867,720                         | \$ 886,355   | (2)         | Decrease for the electric utility segment, partly offset by an increase for the bank segment   |
| Operating income                                     | 91,702                             | 94,490       | (3)         | Decreases for the bank and other segments, partly offset by an increase for the electric utility segment   |
| Net income for common stock                          | 47,706                             | 48,404       | (1)         | Lower operating income, largely offset by lower income taxes   |
| Basic earnings per common share                      | \$ 0.49                            | \$ 0.50      | (2)         | Lower net income   |
| Weighted-average number of common shares outstanding | 97,157                             | 95,873       | 1           | Issuances of shares under the HEI Dividend Reinvestment and Stock Purchase Plan and Company employee plans   |
| (in thousands, except per share amounts)             | Nine months ended<br>September 30  |              | %<br>change | Primary reason(s) for<br>significant change*   |
|  | 2012                               | 2011         |             |  |
| Revenues   | \$ 2,536,848                       | \$ 2,391,307 | 6           | Increase for the electric utility and other segments, partly offset by a decrease for the bank segment   |
| Operating income                                     | 246,924                            | 221,526      | 11          | Increase for the electric utility segment, partly offset by decreases for the bank and other segments  |
| Net income for common stock                          | 124,822                            | 104,005      | 20          | Higher operating income, lower interest expense other than on deposit liabilities and other bank borrowings and higher AFUDC, partly offset by higher income taxes |
| Basic earnings per common share                      | \$ 1.29                            | \$ 1.09      | 18          | Higher net income  |

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|  |        |        |   |  |
|--|--------|--------|---|--|
| Weighted-average number of common shares outstanding | 96,674 | 95,365 | 1 | Issuances of shares under the HEI Dividend Reinvestment and Stock Purchase Plan and Company employee plans |
|--|--------|--------|---|--|

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\* Also, see segment discussions which follow.

Notes: The Company's effective tax rates (combined federal and state) for the third quarters of 2012 and 2011 were 35% and 36%, respectively, and for the first nine months of 2012 and 2011 were 36% and 35%, respectively. The lower effective rate for the third quarter of 2012 compared to the same period in 2011 was due primarily to the favorable settlement of the IRS examination of tax years 2007-2009 in 2012. The higher effective tax rate for the first nine months of 2012 compared to the same period in 2011 was due primarily to prior year items (tax benefits recognized as a result of a favorable settlement with the IRS regarding China investment losses and nontaxable bank-owned life insurance proceeds received) and lower utility state tax credit amortization in 2012, partly offset by the impact of the favorable settlement of the IRS examination of tax years 2007-2009 in 2012.

HEI's consolidated ROACE was 10.1% for the twelve months ended September 30, 2012 and 8.5% for the twelve months ended September 30, 2011.

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**Dividends.** The payout ratios for the first nine months of 2012 and full year 2011 were 72% and 86%, respectively. HEI currently expects to maintain the dividend at its present level; however, the HEI Board of Directors evaluates the dividend quarterly and considers many factors in the evaluation, including but not limited to the Company's results of operations, the long-term prospects for the Company, and current and expected future economic conditions.

**Economic conditions.**

*Note: The statistical data in this section is from public third-party sources (e.g., Department of Business, Economic Development and Tourism (DBEDT); University of Hawaii Economic Research Organization (UHERO); U.S. Bureau of Labor Statistics; Blue Chip Economic Indicators; U.S. Energy Information Administration; Hawaii Tourism Authority (HTA); Honolulu Board of REALTORS®; Bureau of Economic Analysis and national and local newspapers).*

Hawaii's tourism industry, a significant driver of Hawaii's economy, continued to improve in 2012. State visitor arrivals grew by 9.6% in the first nine months of 2012 over the same period in 2011. State visitor expenditures also continued to grow, increasing by 19.5% September year-to-date 2012 over the same period in 2011. Hotel occupancies and room rates also continued to rise. The outlook for the visitor industry remains positive with the Hawaii Tourism Authority expecting a 9% increase in airline seat capacity for 2012 over 2011.

Hawaii's unemployment rate was 5.7% in September 2012, lower than the state's 6.8% rate in September 2011 and the September 2012 national unemployment rate of 7.8%. Hawaii's unemployment rate has slowly improved after reaching a high of 7.1% in 2009.

For the first nine months of 2012 compared to the same period in 2011, the median sales price for single family residential homes on Oahu increased by 8.8% and home sales increased 3.5%. The September year-to-date 2012 Oahu condominium median sales price rose 4.1% above September year-to-date 2011 and closed sales increased 2.6%.

Hawaii's petroleum product prices reflect supply and demand in the Asia-Pacific region and the price of crude oil in international markets. The dramatic reduction in Japan's nuclear production following the tragic earthquake and tsunami in March 2011 has increased regional demand for energy supplies, including petroleum, such that the prices of the utilities' fuels have remained relatively elevated in the first nine months of 2012 compared to the same period in 2011.

The Federal Open Market Committee (FOMC) took additional steps to stimulate the U.S. economy on September 13, 2012, based on the current moderate economic outlook. The FOMC held the federal funds rate target at 0 to 0.25% and expects to maintain the record low rates at least through mid-2015, six months longer than previously expected. The FOMC's concern that economic growth may not be strong enough to generate sustained improvement in labor market conditions resulted in a decision to purchase \$40 billion per month of additional agency mortgage-backed securities. The FOMC also decided to continue other previously announced actions in order to put downward pressure on longer-term interest rates, support mortgage markets, and assist broader accommodative financial conditions. The FOMC stated it is also prepared to take further action as appropriate to support a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability.

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Overall, Hawaii's economy is expected to see only modest growth in 2012 and 2013 with local economic growth supported by moderate improvement in the U.S. economy and impeded by continued uncertainty in global economies. Based on updated economic projections and expectations of renewable self-generation and energy-efficiency additions, the electric utilities' 2013 energy sales are expected to decline slightly from 2012 levels and then remain relatively flat until 2022.

**Recent tax developments.** The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 contained major tax provisions that continue to impact the Company, including the 50% and 100% bonus depreciation provisions for qualified property that result in an estimated net increase in federal tax depreciation of \$153 million for 2011 and \$116 million for 2012, primarily attributable to the utilities.

In December 2011, the Internal Revenue Service (IRS) issued regulations, which provide a framework for determining whether expenditures are deductible as repairs, effective January 1, 2012. The IRS is expected to issue additional revenue procedures containing transitional rules and guidance. The Company is reviewing these regulations and will analyze subsequently issued guidance for their impacts and for the opportunities they present for 2012 and future years.

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**Health care reform.** On June 28, 2012, the US Supreme Court upheld the Patient Protection and Affordable Care Act, the 2010 health care reform law. Currently, Hawaii's Prepaid Health Care Act generally provides greater benefits to employees and dependents because of cost sharing limitations. The Company will continue to comply with its obligations under these laws and to monitor the interaction of the state and federal laws.

**Retirement benefits.** For the first nine months of 2012, the Company's defined benefit retirement plans' assets generated a gain, after investment management fees, of 12.1%. The market value of the defined benefit retirement plans' assets of the Company as of September 30, 2012 was \$1.1 billion (including \$1.0 billion for the utilities) compared to \$983 million at December 31, 2011 (including \$893 million for the utilities).

The Company now estimates that the cash funding for its retirement benefit plans in 2012 will be \$78 million (\$63 million by the utilities, \$13 million by ASB (for its frozen defined benefit pension plan) and \$2 million by HEI), which more than satisfies the minimum funding requirements under the Pension Protection Act of 2006 and considers the requirements of the utilities' tracking mechanisms, the plans' funded status and funding policy. The previous estimates of cash funding in 2012 for the retirement benefit plans were \$104 million for the utilities and \$3 million for HEI, but these estimates were revised in the third quarter of 2012 as a result of the enactment of MAP-21. MAP-21 changed the methodology for determining the interest rates used in calculating the minimum funding requirement of the Company's pension plans and had the effect of increasing the 2012 Adjusted Funding Target Attainment Percentage under the Pension Protection Act of 2006 and reducing near-term requirements for contributions to the plans. MAP-21 also provides for increases in the premiums that the Company will be required to pay in future years to the Pension Benefit Guaranty Corporation.

The following table reflects the sensitivity to the qualified defined benefit pension projected benefit obligation (PBO) as of December 31, 2012, associated with a change in the pension benefits discount rate actuarial assumption by the indicated basis points and constitutes forward-looking statements.

| Actuarial Assumption           | Change in 5.19%<br>assumption in basis points | Impact on HEI<br>consolidated PBO | Impact on HECO<br>consolidated PBO |
|--------------------------------|---|-----------------------------------|------------------------------------|
| Pension benefits discount rate | - 100/+100                                    | \$210 million/\$(168) million     | \$194 million/\$(155) million      |

**Commitments and contingencies.** See Note 8 of HEI's Notes to Consolidated Financial Statements.

**Other segment.**

| (in thousands) | Three months<br>ended<br>September 30 |         | Nine months<br>ended<br>September 30 |          | Primary reason(s) for<br>significant change  |
|----------------|---------------------------------------|---------|--------------------------------------|----------|--|
|                | 2012                                  | 2011    | 2012                                 | 2011     |  |
| Revenues       | \$ 29                                 | \$ 1    | \$ 22                                | \$ (751) | Lower losses on venture capital investments  |
| Operating loss | (4,739)                               | (3,635) | (13,053)                             | (9,899)  | Higher administrative and general expenses, including compensation and employee benefits expense |
| Net loss       | (4,877)                               | (5,012) | (14,503)                             | (14,670) |  |

Higher operating loss, more than offset by lower interest expense due in part to lower long-term debt

The other business segment includes results of the stand-alone corporate operations of HEI and American Savings Holdings, Inc. (ASHI), both holding companies; HEI Properties, Inc., a company holding passive, venture capital investments; The Old Oahu Tug Service, Inc., a maritime freight transportation company that ceased operations in 1999; and Pacific Energy Conservation Services, Inc., a contract services company which provided windfarm operational and maintenance services to an affiliated electric utility until the windfarm was dismantled (dissolved in April 2011); as well as eliminations of intercompany transactions.

Table of Contents**FINANCIAL CONDITION**

**Liquidity and capital resources.** The Company believes that its ability to generate cash, both internally from electric utility and banking operations and externally from issuances of equity and debt securities, commercial paper and bank borrowings, is adequate to maintain sufficient liquidity to fund its contractual obligations and commercial commitments, its forecasted capital expenditures and investments, its expected retirement benefit plan contributions and other cash requirements for the foreseeable future.

The consolidated capital structure of HEI (excluding deposit liabilities and other bank borrowings) was as follows:

| (dollars in millions)                 | September 30, 2012 |      | December 31, 2011 |      |
|---------------------------------------|--------------------|------|-------------------|------|
| Short-term borrowings other than bank | \$ 82              | 3%   | \$ 69             | 2%   |
| Long-term debt, net other than bank   | 1,430              | 45   | 1,340             | 45   |
| Preferred stock of subsidiaries       | 34                 | 1    | 34                | 1    |
| Common stock equity                   | 1,607              | 51   | 1,529             | 52   |
|                                       | \$ 3,153           | 100% | \$ 2,972          | 100% |

HEI's short-term borrowings and HEI's line of credit facility were as follows:

| (in millions)   | Nine months ended<br>September 30, 2012<br>Average balance | September 30, 2012 | Balance<br>December 31, 2011 |     |
|---|--|--------------------|------------------------------|-----|
| Short-term borrowings(1)  |  |                    |                              |     |
| Commercial paper  | \$ 49  | \$ 38              | \$ 69                        |     |
| Line of credit draws  |  |                    |                              |     |
| Undrawn capacity under HEI's line of credit facility<br>(expiring December 5, 2016) | 125  | 125                |                              | 125 |

(1) This table does not include HECO's separate commercial paper issuances and line of credit facilities and draws, which are disclosed below under Electric utility Financial Condition Liquidity and capital resources. The maximum amount of external short-term borrowings during the first nine months of 2012 was \$99 million. At October 26, 2012, HEI had \$47 million in outstanding commercial paper and its line of credit facility was undrawn.

HEI has a line of credit facility of \$125 million (see Note 11 of HEI's Notes to Consolidated Financial Statements). There are customary conditions which must be met in order to draw on it, including compliance with its covenants (such as covenants preventing HEI's subsidiaries from entering into agreements that restrict the ability of the subsidiaries to pay dividends to, or to repay borrowings from, HEI). In addition to customary defaults, HEI's failure to maintain its financial ratios, as defined in the credit agreement, or meet other requirements may result in an event of default. For example, it is an event of default if HEI fails to maintain a nonconsolidated Capitalization Ratio (funded debt) of 50% or less (ratio of 17% as of September 30, 2012, as calculated under the credit agreement) and Consolidated Net Worth of at least \$975 million (Net Worth of \$1.7 billion as of September 30, 2012, as calculated under the credit agreement), or if HEI no longer owns HECO. The commitment fee and interest charges on drawn amounts under the credit agreement are subject to adjustment in the event of a change in HEI's long-term credit ratings.

The Company raised \$35 million through the issuance of approximately 1.3 million shares of common stock under the DRIP, the HEIRSP, ASB 401(k) Plan and other plans during the first nine months of 2012. From August 18, 2011 to January 8, 2012, HEI had been satisfying the requirements of the DRIP, HEIRSP, ASB 401(k) Plan and other plans through open market purchases of its common stock. On January 9, 2012, HEI began satisfying these requirements through new issuances of its common stock.

On March 24, 2011, HEI issued \$125 million of Senior Notes via a private placement (\$75 million of 4.41% notes due March 24, 2016 and \$50 million of 5.67% notes due March 24, 2021). HEI used part of the net proceeds from the issuance of the Senior Notes to pay down commercial paper (originally issued to refinance \$50 million of 4.23% medium-term notes that matured on March 15, 2011) and ultimately used the remaining proceeds to refinance part of the \$100 million of 6.141% medium-term notes that matured on August 15, 2011. The Senior Notes contain customary representation and warranties, affirmative and negative covenants, and events of default (the occurrence of which may result in some or all of the notes then outstanding becoming immediately due and payable) and



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provisions requiring the maintenance by HEI of certain financial ratios generally consistent with those in HEI's revolving noncollateralized credit agreement. For example, see discussion of Capitalization Ratio and Consolidated Net Worth above.

For the first nine months of 2012, net cash provided by operating activities of consolidated HEI was \$122 million. Net cash used by investing activities for the same period was \$297 million, due to HECO's consolidated capital expenditures and net increases in ASB's loans held for investment and investment and mortgage-related securities. Net cash provided by financing activities during this period was \$74 million as a result of several factors, including net increases in long-term debt, deposit liabilities and short-term borrowings and proceeds from the issuance of common stock under HEI plans, partly offset by the payment of common stock dividends and a net decrease in retail repurchase agreements. Other than capital contributions from their parent company, intercompany services (and related intercompany payables and receivables), HECO's periodic short-term borrowings from HEI (and related interest) and the payment of dividends to HEI, the electric utility and bank segments are largely autonomous in their operating, investing and financing activities. (See the electric utility and bank segments' discussions of their cash flows in their respective Financial condition Liquidity and capital resources sections below.) During the first nine months of 2012, HECO and ASB paid dividends to HEI of \$55 million and \$30 million, respectively.

**CERTAIN FACTORS THAT MAY AFFECT FUTURE RESULTS AND FINANCIAL CONDITION**

The Company's results of operations and financial condition can be affected by numerous factors, many of which are beyond the Company's control and could cause future results of operations to differ materially from historical results. For information about certain of these factors, see pages 50 to 51, 66 to 69, and 79 to 81 of HEI's MD&A included in Part II, Item 7 of HEI's 2011 Form 10-K.

Additional factors that may affect future results and financial condition are described on pages iv and v under Forward-Looking Statements.

**MATERIAL ESTIMATES AND CRITICAL ACCOUNTING POLICIES**

In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ significantly from those estimates.

In accordance with SEC Release No. 33-8040, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, management has identified the accounting policies it believes to be the most critical to the Company's financial statements that is, management believes that these policies are both the most important to the portrayal of the Company's results of operations and financial condition, and currently require management's most difficult, subjective or complex judgments.

For information about these material estimates and critical accounting policies, see pages 51 to 52, 69 to 70, and 81 to 82 of HEI's MD&A included in Part II, Item 7 of HEI's 2011 Form 10-K.

Following are discussions of the results of operations, liquidity and capital resources of the electric utility and bank segments.

**Electric utility**

**RESULTS OF OPERATIONS**

**Utility strategic progress.** In 2011 and the first nine months of 2012, the utilities continued to make significant progress in implementing their clean energy strategies and the PUC issued several important regulatory decisions, all of which are key steps to support Hawaii's efforts to reduce its dependence on oil. Included in the PUC decisions were a number of interim and final rate case decisions (see table in "Most recent rate proceedings" below). Additional PUC decisions are needed that will allow the utilities to recover their increasing expenditures for clean energy and reliability on a more timely basis.

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The utilities are committed to achieving or exceeding the State's Renewable Portfolio Standard goal of 40% renewable energy by 2030 (see Clean energy strategy below). In addition, while it will not take precedence over the utilities' work to increase their use of renewable energy, the utilities are also working with the State of Hawaii and other entities to examine the possibility of using liquefied natural gas as a cleaner and lower cost fuel to replace, at least in part, the petroleum oil that would otherwise be used for the remaining generation.

Regulatory. With PUC approval, decoupling was implemented by HECO on March 1, 2011, by HELCO on April 9, 2012 and by MECO on May 4, 2012. Decoupling is a regulatory model that is intended to facilitate meeting the State of Hawaii's goals to transition to a clean energy economy and achieve an aggressive renewable portfolio standard. The decoupling model implemented in Hawaii delinks revenues from sales and includes annual revenue adjustments for O&M expenses and rate base additions. The decoupling mechanism has three components: (1) a sales decoupling component via a revenue balancing account (RBA), (2) a revenue escalation component via a revenue adjustment mechanism (RAM) and (3) an earnings sharing mechanism, which would provide for a reduction of revenues between rate cases in the event the utility exceeds the ROACE allowed in its most recent rate case. Decoupling provides for more timely cost recovery and earning on investments. The implementation of decoupling has resulted in an improvement in the utilities' under-earning situation that has existed over the last several years. Prior to and during the transition to decoupling, however, the utilities' returns have been well below PUC-allowed returns.

Under decoupling, the most significant drivers for improving earnings are:

1. completing major capital projects within PUC approved amounts and on schedule;
2. managing O&M expenses relative to authorized O&M adjustments; and
3. regulatory outcomes that cover O&M requirements and rate base items not included in the RAMs.

Critical to improving earnings are the outcomes of the regulatory audits to be conducted on certain major projects. See Major projects in Note 5 to HECO's Notes to Consolidated Financial Statements for a discussion of the regulatory audits ordered by the PUC.

Future earnings growth is also dependent on rate base growth. The utilities' five-year 2012-2016 forecast reflects net capital expenditures of \$3.0 billion and a compounded annual rate base growth rate in the range of 7% to 9%. Many of the major initiatives within this forecast are expected to be completed beyond the 5-year period. Major initiatives which comprise approximately 40% of the 5-year plan include projects relating to: (1) environmental compliance; (2) fuel infrastructure investments; (3) new generation; and (4) infrastructure investments to integrate more energy from renewables into the system. Estimates for these initiatives could change with time, based on external factors such as the timing and technical requirements for environmental compliance.

Actual and PUC-allowed (as of September 30, 2012) returns were as follows:

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| %   | Return on average rate base (RORB)* |        |        | ROACE** |        |        |
|---|-------------------------------------|--------|--------|---------|--------|--------|
|   | HECO                                | HELCO  | MECO   | HECO    | HELCO  | MECO   |
| <b>Twelve months ended September 30, 2012</b> |                                     |        |        |         |        |        |
| Utility returns                               | 8.35                                | 7.63   | 6.54   | 9.40    | 7.53   | 7.14   |
| PUC-allowed returns                           | 8.11                                | 8.31   | 7.91   | 10.00   | 10.00  | 10.00  |
| Difference                                    | 0.24                                | (0.68) | (1.37) | (0.60)  | (2.47) | (2.86) |

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\* Based on recorded operating income and average rate base, both adjusted for items not included in determining electric rates.

\*\* Recorded net income divided by average common equity.

The approval of decoupling by the PUC will help the utilities to gradually improve their ROACEs beyond 2012, which will facilitate the utilities ability to effectively raise capital for needed infrastructure investments. However, the utilities continue to expect an ongoing gap between their PUC-allowed ROACEs and the ROACEs they actually achieve. The timing of general rate case decisions, the effective date of the RAMs and the PUC's consistent exclusion of certain expenses from rates are estimated to have a consolidated ROACE impact of 120 to 150 basis points per year. In addition, there are other items that are not covered by the annual RAMs that could also have an ongoing impact on the ROACEs actually achieved by the utilities. For example, investments in software projects, O&M in excess of indexed escalations and changes in fuel inventory must be addressed in a general rate case. While the specific magnitude of the impact can fluctuate depending on the size of the projects and exogenous factors, the utilities anticipate that these items could incrementally impact consolidated ROACE by 50 to 75 basis points in each of the next two years.

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***Decoupling implementation.*** Effective March 1, 2011, as part of the decoupling implementation, HECO established the RBA and started recording the difference between target revenues from its HECO 2009 rate case and actual revenues. Beginning June 1, 2011, HECO began accruing and collecting 2011 RAM revenues of \$15 million annually, or \$1.3 million per month, which was superseded on July 26, 2011 by the implementation of interim rates in HECO's 2011 rate case. The HECO 2011 rate case interim D&O reset target revenues, O&M expenses and rate base for the decoupling mechanisms until the final D&O was issued on June 29, 2012 and final rates went into effect on September 1, 2012. Under the decoupling tariff order, in future non-rate case years, HECO will accrue and collect 7/12ths of the annual RAM adjusted revenues in one year and the remaining 5/12ths in the following year. HECO's 2012 annual decoupling filing for the tariff that is effective June 1, 2012 through May 31, 2013 reflects a RAM adjustment of \$7.0 million (\$3.7 million for O&M costs and \$3.3 million for invested capital). The filing also includes the collection of the accrued RBA balance as of December 31, 2011 and associated revenue taxes of \$22.4 million.

HELCO and MECO began tracking the target revenues and actual recorded revenues via RBAs on April 9, 2012 and May 4, 2012, respectively, when their 2010 test year final rates went into effect.

HELCO's tariff for its annual RAM for 2012 reflects a revenue adjustment that results in a reduction in annual revenues of \$2.1 million, effective through May 31, 2013. MECO filed its 2012 RAM (calculated to be \$0.1 million) for informational purposes only since the pending interim D&O for its 2012 test year rate case was anticipated to be issued shortly. MECO's interim D&O for its 2012 test year rate case was issued on May 21, 2012.

See Economic conditions in the HEI Consolidated section above.

**Results.**

| Three months ended |      | September 30 |      | Increase<br>(decrease) | (in millions)  |
|--------------------|------|--------------|------|------------------------|--|
| 2012               | 2011 | 2012         | 2011 |                        |  |
| \$                 | 801  | \$           | 820  | \$ (19)                | <b>Revenues.</b>   |
|                    |      |              |      |                        | (30) Lower fuel oil and purchased energy expense and lower kilowatthour (KWH) sales adjusted for decoupling mechanisms and revenue taxes thereon |
|                    |      |              |      |                        | 5 Rate increase granted to HECO for the 2011 test year   |
|                    |      |              |      |                        | 3 Rate increase granted to MECO for the 2012 test year   |
|                    | 327  |              | 352  | (25)                   | <b>Fuel oil expense.</b> Decrease largely due to less KWHs generated, partly offset by higher fuel costs   |
|                    | 187  |              | 188  | (1)                    | <b>Purchased power expense.</b> Decrease due to lower purchased energy costs, partly offset by higher KWHs purchased                             |
|                    | 101  |              | 94   | 7                      | <b>Operation and maintenance expenses..</b>  |
|                    |      |              |      |                        | 5 Higher customer service expenses   |
|                    | 111  |              | 111  |                        | <b>Other expenses.</b>   |
|                    | 75   |              | 75   |                        | <b>Operating income.</b>   |

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| 38        | 38        | Net income for common stock.                                  |
|-----------|-----------|---|
|           |           | 4 HECO and MECO rate increases                                |
|           |           | (4) Higher O&M expense  |
| 2,362     | 2,448     | (86) Kilowatthour sales (millions)                            |
| 70.8      | 71.5      | (0.7) Wet-bulb temperature (Oahu average; degrees Fahrenheit) |
| 1,419     | 1,504     | (85) Cooling degree days (Oahu)                               |
| \$ 139.68 | \$ 135.66 | \$ 4.02 Average fuel oil cost per barrel                      |

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| Nine months ended<br>September 30 |            |           | Increase<br>(decrease) |     | (in millions)  |
|-----------------------------------|------------|-----------|------------------------|-----|--|
| 2012                              | 2011       |           |                        |     |  |
| \$ 2,340                          | \$ 2,194   | \$ 146    |                        |     |  |
|                                   |            |           |                        |     | <b>Revenues.</b>   |
|                                   |            |           |                        | 102 | Higher fuel oil and purchased energy expense, partially offset by lower KWH sales adjusted for decoupling mechanisms and revenue taxes thereon |
|                                   |            |           |                        | 31  | Rate increase granted to HECO for the 2011 test year   |
|                                   |            |           |                        | 4   | Rate increase granted to MECO for the 2012 test year   |
| <b>986</b>                        | <b>925</b> | <b>61</b> |                        |     | <b>Fuel oil expense.</b> Increase largely due to higher fuel costs, partly offset by less KWHs generated                                       |
| <b>540</b>                        | <b>508</b> | <b>32</b> |                        |     | <b>Purchased power expense.</b> Increase largely due to higher purchased energy costs and KWHs purchased                                       |
| <b>288</b>                        | <b>287</b> | <b>1</b>  |                        |     | <b>Operation and maintenance expenses.</b>   |
|                                   |            |           |                        | 8   | Higher customer service expenses   |
|                                   |            |           |                        | 3   | Increase in general liability reserve for an environmental matter  |
|                                   |            |           |                        | (8) | Increase in capitalization of administrative costs, which lowered administrative and general expenses  |
|                                   |            |           |                        | (3) | Regulatory decision allowing reversal of previously expensed interisland wind project support costs  |
| <b>332</b>                        | <b>311</b> | <b>21</b> |                        |     | <b>Other expenses.</b>   |
|                                   |            |           |                        | 10  | Higher taxes other than income taxes primarily resulting from higher revenue   |
| <b>194</b>                        | <b>163</b> | <b>31</b> |                        |     | <b>Operating income.</b> Increase largely due to the interim rate increase for HECO  |
| <b>95</b>                         | <b>74</b>  | <b>21</b> |                        |     | <b>Net income for common stock.</b>  |
|                                   |            |           |                        | 19  | HECO and MECO rate increases   |
|                                   |            |           |                        | 2   | Higher AFUDC   |
| 6,870                             | 7,159      |           | (289)                  |     | Kilowatthour sales (millions)  |
| 68.7                              | 70.0       |           | (1.3)                  |     | Wet-bulb temperature (Oahu average; degrees Fahrenheit)  |
| 3,430                             | 3,681      |           | (251)                  |     | Cooling degree days (Oahu)   |
| \$ 139.65                         | \$ 120.13  | \$ 19.52  |                        |     | Average fuel oil cost per barrel   |

Notes: In the fourth quarter of 2011, HECO recorded an adjustment of \$6 million to revenues related to the third quarter of 2011, which decreased net income for the fourth quarter of 2011 by \$3 million.

The electric utilities had effective tax rates for the third quarters of 2012 and 2011 of 37% and 38%, respectively, and for the first nine months of 2012 and 2011 of 38%. The lower effective rate for the third quarter of 2012 compared to the same period in 2011 was due primarily to the favorable settlement of the IRS examination of tax years 2007-2009 in 2012.

HECO's consolidated ROACE was 8.64% for the twelve months ended September 30, 2012 and 6.95% for the twelve months ended September 30, 2011.

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Other operation and maintenance expenses for the full year 2012 are expected to be approximately 4% higher than 2011 (lower than the 6% increase previously estimated).

**Most recent rate proceedings.** The electric utilities initiate PUC proceedings (currently, every third year) to request electric rate increases to cover rising operating costs and the cost of plant and equipment, including the cost of new capital projects to maintain and improve service reliability. The PUC may grant an interim increase within 10 to 11 months following the filing of an application, but there is no guarantee of such an interim increase and interim amounts collected are refundable, with interest, to the extent they exceed the amount approved in the PUC's final D&O. The timing and amount of any final increase is determined at the discretion of the PUC. The adoption of revenue, expense, rate base and cost of capital amounts (including the ROACE and RORB) for purposes of an interim rate increase does not commit the PUC to accept any such amounts in its final D&O.



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The following table summarizes certain details of each utility's most recent rate cases, including the details of the increases requested, whether the utility and the Consumer Advocate reached a settlement that they proposed to the PUC, the details of any granted interim and final PUC D&O increases, and whether an interim or final PUC D&O remains pending.

| Test year<br>(dollars in millions) | Date<br>(applied/<br>implemented) | Amount   | % over<br>rates in<br>effect | ROACE<br>(%) | RORB<br>(%) | Rate base | Common<br>equity<br>% | Stipulated<br>agreement<br>reached with<br>Consumer<br>Advocate | Reflects<br>decoupling |
|------------------------------------|-----------------------------------|----------|------------------------------|--------------|-------------|-----------|-----------------------|---|------------------------|
| <b>HECO</b>                        |                                   |          |                              |              |             |           |                       |   |                        |
| <b>2009</b>                        |                                   |          |                              |              |             |           |                       |   |                        |
| Request (1)                        | 7/3/08                            | \$ 97.0  | 5.2                          | 11.25        | 8.81        | \$ 1,408  | 54.30                 | Yes   | No                     |
| Interim increase                   | 8/3/09                            | 61.1     | 4.7                          | 10.50        | 8.45        | 1,169     | 55.81                 |   | No                     |
| Interim increase (adjusted)        | 2/20/10                           | 73.8     | 5.7                          | 10.50        | 8.45        | 1,251     | 55.81                 |   | No                     |
| Final increase (2)                 | 3/1/11                            | 66.4     | 5.1                          | 10.00        | 8.16        | 1,250     | 55.81                 |   | Yes                    |
| <b>2011 (3)</b>                    |                                   |          |                              |              |             |           |                       |   |                        |
| Request                            | 7/30/10                           | \$ 113.5 | 6.6                          | 10.75        | 8.54        | \$ 1,569  | 56.29                 | Yes   | Yes                    |
| Interim increase                   | 7/26/11                           | 53.2     | 3.1                          | 10.00        | 8.11        | 1,354     | 56.29                 |   | Yes                    |
| Interim increase (adjusted)        | 4/2/12                            | 58.2     | 3.4                          | 10.00        | 8.11        | 1,385     | 56.29                 |   | Yes                    |
| Interim increase (adjusted)        | 5/21/12                           | 58.8     | 3.4                          | 10.00        | 8.11        | 1,386     | 56.29                 |   | Yes                    |
| Final increase                     | 9/1/12                            | 58.1     | 3.4                          | 10.00        | 8.11        | 1,386     | 56.29                 |   | Yes                    |
| <b>HELCO</b>                       |                                   |          |                              |              |             |           |                       |   |                        |
| <b>2010 (4)</b>                    |                                   |          |                              |              |             |           |                       |   |                        |
| Request                            | 12/9/09                           | \$ 20.9  | 6.0                          | 10.75        | 8.73        | \$ 487    | 55.91                 | Yes   | Yes                    |
| Interim increase                   | 1/14/11                           | 6.0      | 1.7                          | 10.50        | 8.59        | 465       | 55.91                 |   | No                     |
| Interim increase (adjusted)        | 1/1/12                            | 5.2      | 1.5                          | 10.50        | 8.59        | 465       | 55.91                 |   | No                     |
| Final increase                     | 4/9/12                            | 4.5      | 1.3                          | 10.00        | 8.31        | 465       | 55.91                 |   | Yes                    |
| <b>2013</b>                        |                                   |          |                              |              |             |           |                       |   |                        |
| Request (5)                        | 8/16/12                           | \$ 19.8  | 4.2                          | 10.25        | 8.30        | \$ 455    | 57.05                 |   | Yes                    |
| <b>MECO</b>                        |                                   |          |                              |              |             |           |                       |   |                        |
| <b>2010 (6)</b>                    |                                   |          |                              |              |             |           |                       |   |                        |
| Request                            | 9/30/09                           | \$ 28.2  | 9.7                          | 10.75        | 8.57        | \$ 390    | 56.86                 | Yes   | Yes                    |
| Interim increase                   | 8/1/10                            | 10.3     | 3.3                          | 10.50        | 8.43        | 387       | 56.86                 |   | No                     |
| Interim increase (adjusted)        | 1/12/11                           | 8.5      | 2.7                          | 10.50        | 8.43        | 387       | 56.86                 |   | No                     |
| Final increase                     | 5/4/12                            | 4.7      | 1.5                          | 10.00        | 8.15        | 387       | 56.86                 |   | Yes                    |
| <b>2012</b>                        |                                   |          |                              |              |             |           |                       |   |                        |
| Request (7)                        | 7/22/11                           | \$ 27.5  | 6.7                          | 11.00        | 8.72        | \$ 393    | 56.85                 | Yes   | Yes                    |
| Interim increase                   | 6/1/12                            | 13.1     | 3.2                          | 10.00        | 7.91        | 393       | 56.86                 |   | Yes                    |

Note: The Request Date reflects the application filing date for the rate proceeding. All other line items reflect the effective dates of the revised schedules and tariffs as a result of PUC-approved increases.

(1) In April 2009, HECO reduced this rate increase request by \$6.2 million because a new Customer Information System would not be placed in service as originally planned (see Note 5 of HECO's Notes to Consolidated Financial Statements).

(2) Because the final increase was \$7.4 million less in annual revenues, HECO refunded \$2.1 million to customers (including interest) in February 2011.

(3) HECO filed a request with the PUC for a general rate increase of \$113.5 million, based on a 2011 test year and without the then estimated impacts of the implementation of decoupling as proposed in the PUC's separate decoupling proceeding and depreciation rates and methodology as proposed by HECO in a separate depreciation proceeding. Including the estimated effects of the implementation of decoupling at the time, the effective revenue request was \$94.0 million, or 5.4%. HECO's request was primarily to pay for major capital projects and higher O&M costs to maintain and improve service reliability and to recover the costs for several proposed programs to help reduce Hawaii's dependence on imported oil, and to further increase reliability and fuel security.

The \$53.2 million interim increase includes \$15 million in annual revenues already being recovered through the decoupling RAM.

(4) HELCO's request was primarily to cover investments for system upgrade projects, two major transmission line upgrades and increasing O&M expenses. On February 8, 2012, the PUC issued a final D&O, which reflected the approval of decoupling and cost-recovery mechanisms, and on February 21, 2012, HELCO filed its revised tariffs to reflect the increase in rates. On April 4, 2012, the PUC issued an order approving the revised tariffs, which became effective April 9, 2012. HELCO implemented the decoupling mechanism and began tracking the target revenues and actual recorded revenues via a revenue balancing account. HELCO also reset the heat rates and implemented heat rate deadbands and the PPAC, which provides a surcharge mechanism that more closely aligns cost recovery with costs incurred. The revised tariffs reflect a lower increase in annual revenue requirement compared to the interim increase due to factors that became effective concurrently with the revised tariffs (lower depreciation rates and lower ROACE) and therefore, no refund to customers was required.

(5) HELCO's request is required to pay for O&M expenses and additional investments in plant and equipment required to maintain and improve system reliability and to cover the increased costs to support the integration of more renewable energy generation.

(6) MECO's interim increase, effective August 1, 2010, was based on a stipulated agreement reached with the Consumer Advocate and temporary approval of new depreciation rates and methodology in a separate depreciation proceeding. The adjustment to this increase, effective January 12, 2011, reflects

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the final rates from MECO's 2007 test year rate case. On February 13, 2012, the PUC issued an order instructing MECO and the Consumer Advocate to submit a revised stipulated agreement to incorporate the applicable rulings and decisions in D&Os issued in related proceedings since the first stipulation was filed. On March 29, 2012, MECO and the Consumer Advocate filed an updated agreement on all material issues in MECO's 2010 test year rate case proceeding. On May 2, 2012, the PUC issued a final D&O, which approved the updated agreement, and on May 4, 2012, the tariffs implementing the D&O became effective. MECO implemented the decoupling mechanism and began tracking the target revenues and actual recorded revenues via a revenue balancing account. MECO also reset the heat rates and implemented heat rate deadbands and the PPAC, which provides a surcharge mechanism that more closely aligns cost recovery with costs incurred. The revised tariffs reflect a lower increase in annual revenue requirement than the interim increase due to factors that became effective concurrently with the revised tariffs (lower depreciation rates and lower ROACE) and therefore, no refund was required.

(7) MECO's request is required to pay for O&M expenses and additional investments in plant and equipment required to maintain and improve system reliability and to cover the increased costs to support the integration of more renewable energy generation. See discussion below on interim decision and subsequent proposed adjustments to the interim increase.

HECO 2011 test year rate case. On July 22, 2011, the PUC issued an interim D&O in HECO's 2011 test year rate case, which became effective July 26, 2011. The PUC did not approve the portion of the settlement agreement with the Consumer Advocate allowing deferral of certain costs and HECO filed a motion for clarification and/or partial reconsideration of the interim D&O's findings and conclusions on the deferral of costs.

On February 24, 2012, the PUC issued an order which: (1) approved the deferral of interisland wind project support costs of up to \$5.89 million; (2) denied HECO's request to defer certain consultant expenses associated with the Enterprise Resource Planning/Enterprise Asset Management (ERP/EAM) system costs, but allowed HECO to include \$552,000 in its 2011 test year expenses for such costs; and (3) granted HECO's request to defer Customer Information System (CIS) project operation and maintenance (O&M) expenses (limited to \$2,258,000 per year in 2011 and 2012 under the settlement agreement) that are to be subject to a regulatory audit of project costs, and allowed HECO to accrue AFUDC on these deferred costs until the completion of the regulatory audit. As a result of the order, HECO reflected in the first quarter of 2012 the deferral of \$2.3 million (\$1.4 million for the interisland wind project support costs and \$0.9 million for CIS project O&M expenses) incurred from July 22, 2011 through December 31, 2011 that were previously expensed and will also defer any 2012 costs incurred up to the limitations stated in the order.

On February 3, 2012, the parties reached a settlement agreement on the EOTP Phase 1 project costs, agreeing that, in lieu of a regulatory audit, HECO would write-off \$9.5 million of gross plant in service EOTP Phase 1 costs and associated adjustments and carrying charges. The settlement agreement resulted in an after-tax charge to net income in the fourth quarter of 2011 of approximately \$6 million. The parties also agreed to stipulate to an additional annual interim increase of \$5 million to be effective March 1, 2012, based on additional revenue requirements reflecting all remaining EOTP costs not previously included in rates and offset by other minor adjustments to the interim increase that became effective on July 26, 2011. On March 29, 2012, the PUC approved the settlement agreement, and ordered that the regulatory audit for EOTP Phase 1 need not be conducted. HECO submitted a revised tariff to reflect an increase in the interim increase effective April 2, 2012.

On April 20, 2012, HECO requested an adjustment of \$607,000 (i.e., \$552,000 grossed up for revenue taxes) to its interim increase to include the ERP/EAM system evaluation costs in its 2011 test year expenses. HECO submitted a tariff to reflect this adjustment and on May 14, 2012, the PUC approved HECO's request for this interim increase, which became effective May 21, 2012.

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On June 29, 2012, the PUC issued a final D&O in HECO's 2011 test year proceeding, which finalized approval of the previous interim increases already in effect. It also approved a second stipulated settlement agreement entered into on June 27, 2012 by HECO, the Consumer Advocate and the Department of Defense (parties in the proceeding) to reflect an additional reduction in the test year rate increase of \$755,000 to remove parent company non-incentive executive compensation and administrative costs.

On August 9, 2012, the PUC issued an order approving HECO's proposed final tariff sheets and rate schedules, and request for an effective date of September 1, 2012 of the final revised tariffs. Since the final rate increase as a result of the second stipulated supplement to the settlement agreement was lower than the interim increase then currently in effect, HECO refunded customers, effective September 1, 2012 through September 30, 2012, approximately \$0.9 million (which included accrued interest since July 26, 2011).

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***MECO 2012 test year rate case.*** On May 21, 2012, the PUC issued an interim D&O in MECO's 2012 test year rate case, which became effective June 1, 2012. The D&O authorized MECO to reset its target heat rates by fuel type to 2012 test year levels for the purpose of calculating the energy cost adjustment clause (ECAC) adjustment factor, which will help to ensure MECO's continuing recovery of its fuel costs. The interim increase is based on MECO's updated stipulated agreement with the Consumer Advocate filed on May 14, 2012. On July 20, 2012, MECO and the Consumer Advocate filed a stipulated supplement to the stipulated agreement to reduce the test year revenue requirement by \$0.1 million in administrative and general expenses and requested that the final D&O for this rate case incorporate the adjustment into the final 2012 test year revenue requirement.

**Clean energy strategy.** The utilities' policy is to support efforts to increase renewable energy in Hawaii. The utilities believe their actions will help stabilize customer bills over time as they become less dependent on costly and price-volatile fossil fuel. The utilities' clean energy strategy will also allow them to meet Hawaii's RPS law, which requires electric utilities to meet an RPS of 10%, 15%, 25% and 40% by December 31, 2010, 2015, 2020 and 2030, respectively. HECO met the 10% RPS for 2010 with a consolidated RPS of 20.7%, including savings from energy efficiency programs and solar water heating (or 9.5% without DSM energy savings). Energy savings resulting from DSM energy efficiency programs and solar water heating will not count toward the RPS after 2014. Through September 2012, HECO achieved an RPS without DSM energy savings of 13.3%, primarily through a comprehensive portfolio of renewable energy power purchase agreements, net energy metering programs and biofuels. The utilities believe they are on track to meet the 2015 RPS.

Recent developments in the utilities' clean energy strategy include the following (also see the projects discussed under Renewable Energy Projects in Note 5 of HECO's Notes to Consolidated Financial Statements):

- In September 2011, the PUC denied the utilities' requested approval of HELCO's contract with AKP citing the higher cost of the biofuel over the cost of petroleum diesel. In August 2012, HELCO signed a new 20-year contract with Aina Koa Pono-Ka'u LLC (AKP), subject to PUC approval, to supply 16 million gallons of biodiesel per year with initial consumption to begin within five years of PUC approval.
- In February 2011, the PUC opened dockets related to MECO's and HECO's plans to proceed with competitive bidding processes to acquire up to approximately 50 MW and 300 MW, respectively, of new, renewable firm dispatchable capacity generation resources, with the initial increments expected to come on line in 2015 and 2017, respectively. Due to a subsequent lowering of MECO's forecasted peaks, the projected capacity need date on the island of Maui has been deferred to 2019 and the capacity requirement has been reduced to 30 MW. Due to a subsequent lowering of HECO's forecasted sales and peaks, the projected capacity need has been reduced to a range of 150 MW to 200 MW and the timing will be dependent on the possible retirement of generating units. MECO and HECO plan to file draft RFPs for future capacity with the PUC in the fourth quarter of 2012.
- In August 2011, HECO signed a 20-year contract, subject to PUC approval, with Hawaii BioEnergy to supply 10 million gallons per year of biocrude at Kahe Power Plant with initial consumption to begin as early as 2015. In 2011, HECO also signed other contracts, subject to PUC approval, for lesser amounts of biocrude and for biodiesel for testing or operations.
- In May 2012, the PUC approved a 3-year biodiesel supply contract with Renewable Energy Group through July 2015 for continued biodiesel supply to CT-1 of 3 million to 7 million gallons per year.

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- In September 2012, HECO began purchasing test wind energy from the 69 MW Kawaihoa Wind, LLC facility. The wind farm is planned to be placed into full commercial operation by the end of 2012.
- In August 2012, the battery facility at a 30 MW Kahuku wind farm experienced a fire and HECO has not purchased wind energy from the wind farm since then.
- In May 2012, HECO signed a contract, subject to PUC approval, with the City and County of Honolulu to purchase an additional 27 MW of capacity and energy from the existing H-POWER waste-to-energy plant.

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- In May 2012, HELCO signed a power purchase agreement, subject to PUC approval, with Hu Honua Bioenergy for 21.5 MW of renewable, dispatchable firm capacity fueled by locally grown biomass from a facility on the island of Hawaii.
- In August 2012, the PUC approved a waiver from the competitive bidding process to allow HECO to negotiate with the U.S. Department of the Army for construction of a 50 MW utility-owned and operated firm, renewable and dispatchable generation facility at Schofield Barracks on the island of Oahu.
- HECO, HELCO and MECO began accepting energy from feed-in tariff projects in 2011. As of September 30, 2012, there were 4,010 kW, 345 kW and 1,337 kW of installed feed-in tariff capacity from renewable energy technologies at HECO, HELCO and MECO, respectively.
- As of September 30, 2012, there were 62,762 kW, 15,493 kW and 19,744 kW of installed net energy metering capacity from renewable energy technologies at HECO, HELCO and MECO, respectively. Net energy metering is proceeding at a record pace. The amount of net energy metering capacity installed in the first three quarters of 2012 exceeds the amount installed in all of 2011, which itself was at a record level.

**Commitments and contingencies.** See Note 5 of HECO's Notes to Consolidated Financial Statements.

## FINANCIAL CONDITION

**Liquidity and capital resources.** Management believes that HECO's ability, and that of its subsidiaries, to generate cash, both internally from operations and externally from issuances of equity and debt securities, commercial paper and lines of credit, is adequate to maintain sufficient liquidity to fund their respective capital expenditures and investments and to cover debt, retirement benefits and other cash requirements in the foreseeable future.

HECO's consolidated capital structure was as follows:

| (dollars in millions) | September 30, 2012 |      | December 31, 2011 |      |
|-----------------------|--------------------|------|-------------------|------|
| Short-term borrowings | \$ 45              | 2%   | \$ 1,058          | 43%  |
| Long-term debt, net   | 1,148              | 43   | 34                | 1    |
| Preferred stock       | 34                 | 1    | 1,403             | 56   |
| Common stock equity   | 1,443              | 54   | 2,495             | 100% |
|                       | \$ 2,670           | 100% | \$ 2,495          | 100% |

HECO's short-term borrowings (other than from HELCO and MECO) and line of credit facility were as follows:

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| (in millions)   | Average balance<br>Nine months ended<br>September 30, 2012 | September 30,<br>2012 | Balance<br>December 31,<br>2011 |
|---|--|-----------------------|---------------------------------|
| Short-term borrowings(1)  |  |                       |                                 |
| Commercial paper  | \$ 44  | \$ 45                 | \$                              |
| Line of credit draws  |  |                       |                                 |
| Borrowings from HEI   |  |                       |                                 |
| Undrawn capacity under line of credit facility (expiring<br>December 5, 2016) | 175  | 175                   | 175                             |

(1) The maximum amount of external short-term borrowings during the first nine months of 2012 was \$124 million. At September 30, 2012, HECO had \$29 million and \$7 million of short-term borrowings from HELCO and MECO, respectively. These borrowings are eliminated in consolidation. At October 26, 2012, HECO had \$37 million of outstanding commercial paper, its line of credit facility was undrawn, it had no borrowings from HEI and it had short-term borrowings of \$42 million from HELCO and \$8 million from MECO.

HECO has a line of credit facility of \$175 million (see Note 8 of HECO's Notes to Consolidated Financial Statements). There are customary conditions that must be met in order to draw on it, including compliance with several covenants (such as covenants preventing its subsidiaries from entering into agreements that restrict the ability of the subsidiaries to pay dividends to, or to repay borrowings from, HECO, and restricting its ability as well as the ability of any of its subsidiaries to guarantee additional indebtedness of the subsidiaries if such additional debt would cause the subsidiary's Consolidated Subsidiary Funded Debt to Capitalization Ratio to exceed 65% (ratio of 41% for HELCO and 40% for MECO as of September 30, 2012, as calculated under the credit agreement)). In addition to customary defaults, HECO's failure to maintain its financial ratios, as defined in its credit agreement, or meet other



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requirements may result in an event of default. For example, under the credit agreement, it is an event of default if HECO fails to maintain a Consolidated Capitalization Ratio (equity) of at least 35% (ratio of 54% as of September 30, 2012, as calculated under the credit agreement), or if HECO is no longer owned by HEL.

Special purpose revenue bonds (SPRBs) and refunding SPRBs have been issued by the Department of Budget and Finance of the State of Hawaii (DBF) to finance and refinance capital improvement projects of HECO and its subsidiaries, with the source of their repayment being the unsecured financial obligations of HECO and its subsidiaries under loan agreements and notes issued to the DBF, including HECO's guarantees of its subsidiaries' obligations. The payment of principal and interest due on the various series of SPRBs and refunding SPRBs currently outstanding and issued prior to 2009 are insured by one of the following bond insurers: Ambac Assurance Corporation; Financial Guaranty Insurance Company (FGIC), which was placed in a rehabilitation proceeding in the State of New York in June 2012 (in September 2012, a proposed Plan of Rehabilitation was filed); MBIA Insurance Corporation (which bonds have been reinsured by National Public Finance Guarantee Corp.); or Syncora Guarantee Inc. (which bonds have been reinsured by Syncora Capital Assurance Inc.). The Standard & Poor's (S&P's) and Moody's Investor Service's ratings of each of these insurers, which at the time the insured obligations were issued were higher than the ratings of the utilities, are currently either lower than the ratings of the utilities (with the exception of one insurer's higher rating by S&P) or have been withdrawn.

On November 1, 2011, the PUC authorized HECO, HELCO and MECO to issue up to \$150 million, \$10 million and \$10 million, respectively, in one or more registered public offerings or private placements of unsecured obligations bearing taxable interest on or before December 31, 2012. On December 22, 2011, the PUC authorized HECO, HELCO and MECO to issue up to \$217 million, \$34 million and \$60 million, respectively, in one or more registered public offerings and/or private placements of unsecured taxable debt obligations and/or refunding SPRBs through December 31, 2012 to refinance certain series of outstanding SPRBs. The PUC also approved the use of an expedited approval procedure for the approval of additional financings or refinancings by HECO, HELCO and MECO during 2013 through 2015, subject to certain conditions.

On April 19, 2012, HECO, HELCO and MECO issued through a private placement taxable unsecured senior notes of various maturities (the HECO Notes, HELCO Notes and MECO Notes, and together, the April Notes) in the aggregate principal amounts of \$327 million, \$31 million and \$59 million, respectively, with stated interest rates ranging from 3.79% to 5.39%. Proceeds of \$267 million of the April Notes, together with additional funds, were used to redeem an aggregate principal amount of \$271 million of bonds (with stated interest rates ranging from 5.45% to 6.20%). The \$150 million of proceeds of the remaining HECO Notes, bearing interest at 5.39%, were used to finance or refinance capital expenditures.

On September 13, 2012, HECO issued another series of taxable unsecured senior notes through a private placement (the HECO September Notes) in the aggregate principal amount of \$40 million with a stated interest rate of 4.53%. Proceeds of the HECO September Notes, together with additional funds, were used to redeem the \$40 million aggregate principal amount 5.10% Series 2002A SPRBs. See Note 8 of HECO's Notes to Consolidated Financial Statements.

The April Notes and HECO September Note Agreements contain customary representations and warranties, affirmative and negative covenants, and events of default (the occurrence of which may result in some or all of the Notes of each and all of the utilities then outstanding becoming immediately due and payable) and provisions requiring the maintenance by HECO, and each of HELCO and MECO, of certain financial ratios generally consistent with those in HECO's existing amended revolving noncollateralized credit agreement, which established a line of credit facility of \$175 million.

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Operating activities provided \$80 million in net cash during the first nine months of 2012. Investing activities for the same period used net cash of \$188 million for capital expenditures, net of contributions in aid of construction. Financing activities for the same period provided net cash of \$75 million, primarily due to the increase in long-term debt and short-term borrowings, partly offset by payment of \$56 million of common and preferred dividends.

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|                           |    |    |    |    |     |   |
|---------------------------|----|----|----|----|-----|---|
| Interest income           | \$ | 48 | \$ | 50 | (2) | The impact of higher average earning asset balances was more than offset by lower yields on earning assets. ASB's average loan portfolio balance for the third quarter of 2012 was \$95 million higher than for the third quarter of 2011 as the average commercial markets, home equity lines of credit and commercial real estate loan balances increased by \$49 million, \$113 million and \$48 million, respectively. ASB targeted these loan types because of their shorter duration and/or variable rates. Despite a \$150 million increase in residential loan production, the average residential loan portfolio decreased by \$118 million due to higher repayments and loan sales in connection with ASB's long-term strategy to manage interest rate risk. The loan portfolio yield was impacted by the low interest rate environment as new loan production yields were lower than the average portfolio yield. The average investment and mortgage-related securities portfolio balance decreased by \$12 million as ASB experienced higher prepayments on the portfolio, which were used to fund higher loan originations. |
| Noninterest income        |    | 19 |    | 16 | 3   | Higher gain on sale of loans as more residential loans were sold in order to manage interest rate risk.   |
| Revenues                  |    | 67 |    | 66 | 1   |   |
| Interest expense          |    | 3  |    | 4  | (1) | Lower funding costs as a result of the low interest rate environment. Average deposit balances for the third quarter of 2012 increased by \$60 million compared to third quarter of 2011 due to an increase in core deposits of \$129 million, partly offset by a decrease in term certificates of \$69 million. The other borrowings average balance decreased by \$22 million due to the payoff of a maturing FHLB advance in 2011 and lower retail repurchase agreements.  |
| Provision for loan losses |    | 4  |    | 4  |     | The provision for loan losses benefited from lower net charge-offs and improved credit quality associated with the gradual improvement in Hawaii's economy, partly offset by loan loss reserves established for the growth in the loan portfolio.   |
| Noninterest expense       |    | 38 |    | 35 | 3   | Higher new product and project related expenses and higher employee benefit expenses.   |
| Expenses                  |    | 45 |    | 43 | 2   |   |

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|                  |    |    |   |
|------------------|----|----|---|
| Operating income | 22 | 23 | (1) Lower net interest income and higher noninterest expenses, partially offset by higher noninterest income. |
| Net income       | 14 | 15 | (1) Lower operating income.   |

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|                           |    |     |    |     |     |  |
|---------------------------|----|-----|----|-----|-----|--|
| Interest income           | \$ | 143 | \$ | 149 | (6) | The impact of higher average earning asset balances was more than offset by lower yields on earning assets. ASB's average loan portfolio balance for the first nine months of 2012 was \$124 million higher than for the first nine months of 2011 as the average commercial markets, home equity lines of credit and commercial real estate loan balances increased by \$97 million, \$117 million and \$54 million, respectively. ASB targeted these loan types because of their shorter duration and/or variable rates. Despite a \$320 million increase in residential loan production, the average residential loan portfolio decreased by \$139 million due to higher repayments and loan sales in connection with ASB's long-term strategy to manage interest rate risk. The loan portfolio yield was impacted by the low interest rate environment as new loan production yields were lower than the average portfolio yield. The average investment and mortgage-related securities portfolio balance decreased by \$47 million as ASB experienced higher prepayments on the portfolio, which were used to fund higher loan originations. |
| Noninterest income        |    | 53  |    | 49  | 4   | Higher gain on sale of loans as more residential loans were sold in order to manage interest rate risk, partly offset by a nonrecurring insurance gain in 2011.  |
| Revenues                  |    | 196 |    | 198 | (2) |  |
| Interest expense          |    | 9   |    | 11  | (2) | Lower funding costs as a result of the low interest rate environment. Average deposit balances for the first nine months of 2012 increased by \$75 million compared to the first nine months of 2011 due to an increase in core deposits of \$160 million, partly offset by a decrease in term certificates of \$85 million. The other borrowings average balance decreased by \$17 million primarily due to the payoff of a maturing FHLB advance.  |
| Provision for loan losses |    | 10  |    | 11  | (1) | The provision for loan losses benefited from lower net charge-offs and improved credit quality associated with the gradual improvement in Hawaii's economy, partly offset by loan loss reserves established for the growth in the loan portfolio.  |
| Noninterest expense       |    | 111 |    | 107 | 4   | Higher new product and project related expenses and higher employee benefit expenses.  |
| Expenses                  |    | 130 |    | 129 | 1   |  |
| Operating income          |    | 66  |    | 69  | (3) | Lower net interest income and higher noninterest expenses, partially offset by lower provision for loan losses and higher gain on sale of loans.   |
| Net income                |    | 44  |    | 45  | (1) | Lower operating income, partly offset by lower income tax expense.   |



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Details of ASB's other noninterest income and other noninterest expense were as follows:

| (in thousands)                        | Three months ended<br>September 30 |          | Nine months ended<br>September 30 |           |
|---------------------------------------|------------------------------------|----------|-----------------------------------|-----------|
|                                       | 2012                               | 2011     | 2012                              | 2011      |
| Bank-owned life insurance             | \$ 1,004                           | \$ 996   | \$ 2,976                          | \$ 4,107  |
| Other                                 | 342                                | 601      | 1,179                             | 1,870     |
| Total other income                    | \$ 1,346                           | \$ 1,597 | \$ 4,155                          | \$ 5,977  |
| FDIC insurance premium                | \$ 790                             | \$ 828   | \$ 2,497                          | \$ 3,131  |
| Marketing                             | 776                                | 712      | 1,880                             | 2,063     |
| Office supplies, printing and postage | 927                                | 1,158    | 2,836                             | 3,002     |
| Communication                         | 461                                | 539      | 1,327                             | 1,370     |
| Other                                 | 5,142                              | 4,526    | 14,369                            | 14,085    |
| Total other expense                   | \$ 8,096                           | \$ 7,763 | \$ 22,909                         | \$ 23,651 |

See Note 4 of HEI's Notes to Consolidated Financial Statements and Economic conditions in the HEI Consolidated section above.

Management is working to grow its bank franchise in Hawaii and remains focused on maintaining ASB as a high performing community bank with a targeted return on assets of 1.15%-1.2%, net interest margin near 4% and an efficiency ratio in the mid-50s. Despite the revenue pressures across the banking industry, management expects ASB's low-cost funding base, reduced cost structure and lower-risk profile to continue to deliver strong performance compared to industry peers. In the current low interest rate environment, management expects ASB net income for the full year 2012 to be 3% to 5% lower than 2011.

For the nine months ended September 30, 2012, ASB reported a 1.19% return on assets, net interest margin of 3.98% and a 59% efficiency ratio.

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**Average balance sheet and net interest margin.** The following tables set forth average balances, together with interest earned and accrued, and resulting yields and costs:

| Three months ended September 30                      | 2012            |           |                  | 2011            |           |                  |
|--|-----------------|-----------|------------------|-----------------|-----------|------------------|
| (dollars in thousands)                               | Average balance | Interest  | Average rate (%) | Average balance | Interest  | Average rate (%) |
| <b>Assets:</b>                                       |                 |           |                  |                 |           |                  |
| Other investments (1)                                | \$ 188,230      | \$ 57     | 0.12             | \$ 220,861      | \$ 77     | 0.14             |
| Investment and mortgage-related securities           | 631,255         | 3,596     | 2.28             | 643,617         | 3,706     | 2.30             |
| Loans receivable (2)                                 | 3,742,567       | 43,880    | 4.68             | 3,647,753       | 46,240    | 5.06             |
| Total interest-earning assets (3)                    | 4,562,052       | 47,533    | 4.16             | 4,512,231       | 50,023    | 4.42             |
| Allowance for loan losses                            | (39,599)        |           |                  | (39,168)        |           |                  |
| Non-interest-earning assets                          | 428,752         |           |                  | 427,063         |           |                  |
| Total assets   | \$ 4,951,205    |           |                  | \$ 4,900,126    |           |                  |
| <b>Liabilities and shareholder's equity:</b>         |                 |           |                  |                 |           |                  |
| <b>Interest-bearing demand and savings deposits:</b> |                 |           |                  |                 |           |                  |
| Time certificates                                    | \$ 2,530,937    | 348       | 0.05             | \$ 2,551,851    | 688       | 0.11             |
| Total interest-bearing deposits                      | 3,043,767       | 1,540     | 0.20             | 3,133,686       | 2,166     | 0.27             |
| Other borrowings                                     | 223,243         | 1,201     | 2.11             | 244,931         | 1,375     | 2.20             |
| Total interest-bearing liabilities                   | 3,267,010       | 2,741     | 0.33             | 3,378,617       | 3,541     | 0.41             |
| <b>Non-interest bearing liabilities:</b>             |                 |           |                  |                 |           |                  |
| Deposits   | 1,071,592       |           |                  | 922,040         |           |                  |
| Other  | 106,762         |           |                  | 97,664          |           |                  |
| Total liabilities                                    | 4,445,364       |           |                  | 4,398,321       |           |                  |
| Shareholder's equity                                 | 505,841         |           |                  | 501,805         |           |                  |
| Total liabilities and shareholder's equity           | \$ 4,951,205    |           |                  | \$ 4,900,126    |           |                  |
| Net interest income                                  |                 | \$ 44,792 |                  |                 | \$ 46,482 |                  |
| Net interest margin (%) (4)                          |                 |           | 3.92             |                 |           | 4.11             |

| Nine months ended September 30                       | 2012            |          |                  | 2011            |          |                  |
|--|-----------------|----------|------------------|-----------------|----------|------------------|
| (dollars in thousands)                               | Average balance | Interest | Average rate (%) | Average balance | Interest | Average rate (%) |
| <b>Assets:</b>                                       |                 |          |                  |                 |          |                  |
| Other investments (1)                                | \$ 213,793      | \$ 220   | 0.14             | \$ 226,805      | \$ 242   | 0.14             |
| Investment and mortgage-related securities           | 617,021         | 10,910   | 2.36             | 664,078         | 11,351   | 2.28             |
| Loans receivable (2)                                 | 3,721,159       | 133,241  | 4.78             | 3,596,892       | 137,985  | 5.12             |
| Total interest-earning assets (3)                    | 4,551,973       | 144,371  | 4.23             | 4,487,775       | 149,578  | 4.45             |
| Allowance for loan losses                            | (39,029)        |          |                  | (39,689)        |          |                  |
| Non-interest-earning assets                          | 430,198         |          |                  | 420,463         |          |                  |
| Total assets   | \$ 4,943,142    |          |                  | \$ 4,868,549    |          |                  |
| <b>Liabilities and shareholder's equity:</b>         |                 |          |                  |                 |          |                  |
| <b>Interest-bearing demand and savings deposits:</b> |                 |          |                  |                 |          |                  |
| Time certificates                                    | \$ 2,536,930    | 1,216    | 0.06             | \$ 2,513,280    | 2,110    | 0.11             |
| Total interest-bearing deposits                      | 3,065,225       | 5,015    | 0.22             | 3,126,761       | 7,146    | 0.31             |
| Other borrowings                                     | 228,751         | 3,676    | 2.11             | 245,917         | 4,124    | 2.21             |
| Total interest-bearing liabilities                   | 3,293,976       | 8,691    | 0.35             | 3,372,678       | 11,270   | 0.44             |
| <b>Non-interest bearing liabilities:</b>             |                 |          |                  |                 |          |                  |
| Deposits   | 1,041,433       |          |                  | 904,563         |          |                  |
| Other  | 107,929         |          |                  | 92,938          |          |                  |
| Total liabilities                                    | 4,443,338       |          |                  | 4,370,179       |          |                  |



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|  |              |            |              |            |
|--|--------------|------------|--------------|------------|
| Shareholder's equity                       | 499,804      |            | 498,370      |            |
| Total liabilities and shareholder's equity | \$ 4,943,142 |            | \$ 4,868,549 |            |
| Net interest income                        |              | \$ 135,680 |              | \$ 138,308 |
| Net interest margin (%) (4)                |              |            | 3.98         | 4.11       |

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(1) Includes federal funds sold, interest bearing deposits and stock in the FHLB of Seattle.

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- (2) Includes loan fees of \$1.0 million and \$0.8 million for the three months ended September 30, 2012 and 2011, respectively, and \$3.5 million and \$2.7 million for the nine months ended September 30, 2012 and 2011, respectively, together with interest accrued prior to suspension of interest accrual on nonaccrual loans, includes nonaccrual loans.
- (3) Interest income includes taxable equivalent basis adjustments, based upon a federal statutory tax rate of 35%, of \$0.2 million and \$0.1 million for the three months ended September 30, 2012 and 2011, respectively, and \$0.6 million and \$0.4 million for the nine months ended September 30, 2012 and 2011, respectively.
- (4) Defined as net interest income as a percentage of average earning assets.

**Earning assets, costing liabilities and other factors.** Earnings of ASB depend primarily on net interest income, which is the difference between interest earned on earning assets and interest paid on costing liabilities. The current interest rate environment is impacted by disruptions in the financial markets and these conditions may have a negative impact on ASB's net interest margin.

Loan originations and mortgage-related securities are ASB's primary sources of earning assets.

Loan portfolio. ASB's loan volumes and yields are affected by market interest rates, competition, demand for financing, availability of funds and management's responses to these factors. The composition of ASB's loan portfolio was as follows:

| (dollars in thousands)            | September 30, 2012 |            | December 31, 2011 |            |
|-----------------------------------|--------------------|------------|-------------------|------------|
|                                   | Balance            | % of total | Balance           | % of total |
| Real estate loans:                |                    |            |                   |            |
| Residential 1-4 family            | \$ 1,899,580       | 50.5       | \$ 1,926,774      | 52.2       |
| Commercial real estate            | 367,765            | 9.8        | 331,931           | 9.0        |
| Home equity line of credit        | 604,279            | 16.1       | 535,481           | 14.5       |
| Residential land                  | 29,280             | 0.8        | 45,392            | 1.2        |
| Commercial construction           | 42,913             | 1.1        | 41,950            | 1.1        |
| Residential construction          | 5,648              | 0.2        | 3,327             | 0.1        |
| Total real estate loans, net      | 2,949,465          | 78.5       | 2,884,855         | 78.1       |
| Commercial loans                  | 704,100            | 18.7       | 716,427           | 19.4       |
| Consumer loans                    | 104,338            | 2.8        | 93,253            | 2.5        |
|                                   | 3,757,903          | 100.0      | 3,694,535         | 100.0      |
| Less: Deferred fees and discounts | (12,345)           |            | (13,811)          |            |
| Allowance for loan losses         | (39,810)           |            | (37,906)          |            |
| Total loans, net                  | \$ 3,705,748       |            | \$ 3,642,818      |            |

The increase in the total loan portfolio during the first nine months of 2012 was primarily due to an increase in ASB's home equity lines of credit and commercial real estate loan portfolios.

Loan portfolio risk elements. See Note 4 of HEI's Notes to Consolidated Financial Statements.

Investment and mortgage-related securities. ASB's investment portfolio was comprised as follows:

|  | September 30, 2012 | December 31, 2011 |
|--|--------------------|-------------------|
| Federal agency obligations                       | 33%                | 35%               |
| Mortgage-related securities FNMA, FHLMC and GNMA | 55                 | 55                |
| Municipal bonds                                  | 12                 | 10                |
|  | 100%               | 100%              |

Principal and interest on mortgage-related securities issued by Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) are guaranteed by the issuer, and the securities carry implied AA+ ratings.

Deposits and other borrowings. Deposits continue to be the largest source of funds for ASB and are affected by market interest rates, competition and management's responses to these factors. Core deposits continue to be strong, as depositors remain risk averse. Advances from the FHLB of Seattle and securities sold under agreements to repurchase continue to be additional sources of funds. Advances from the FHLB of Seattle have remained at \$50 million from December 31, 2011 to September 30, 2012. As of September 30, 2012 and December 31, 2011, ASB's costing liabilities consisted of 95% deposits and 5% other borrowings. The weighted average cost of deposits for the

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nine months ended September 30, 2012 was 0.16%, compared to 0.24% for the nine months ended September 30, 2011.

**Other factors.** Interest rate risk is a significant risk of ASB's operations and also represents a market risk factor affecting the fair value of ASB's investment securities. Increases and decreases in prevailing interest rates generally translate into decreases and increases in fair value of those instruments. In addition, changes in credit spreads also impact the fair values of those instruments.

Although higher long-term interest rates or other conditions in credit markets (such as the effects of the deteriorated subprime market) could reduce the market value of available-for-sale investment and mortgage-related securities and reduce shareholder's equity through a balance sheet charge to accumulated other comprehensive income (AOCI), this reduction in the market value of investments and mortgage-related securities would not result in a charge to net income in the absence of a sale of such securities or an other-than-temporary impairment in the value of the securities. As of September 30, 2012 and December 31, 2011, the unrealized gains, net of taxes, on available-for-sale investments and mortgage-related securities (including securities pledged for repurchase agreements) in AOCI was \$12 million and \$10 million, respectively. See Item 3. Quantitative and qualitative disclosures about market risk.

During the first nine months of 2012, ASB recorded a provision for loan losses of \$9.5 million primarily due to charge-offs during the year for 1-4 family, residential land, commercial and consumer loans. During the first nine months of 2011, ASB recorded a provision for loan losses of \$10.9 million primarily due to the net charge-offs during the year for 1-4 family, residential land, and commercial loans. Continued financial stress on ASB's customers may result in higher levels of delinquencies and losses.

| (in thousands)  | Nine months ended<br>September 30 |           | Year ended<br>December 31 |  |
|---|-----------------------------------|-----------|---------------------------|--|
|   | 2012                              | 2011      | 2011                      |  |
| Allowance for loan losses, January 1  | \$ 37,906                         | \$ 40,646 | \$ 40,646                 |  |
| Provision for loan losses   | 9,504                             | 10,927    | 15,009                    |  |
| Less: net charge-offs   | 7,600                             | 13,360    | 17,749                    |  |
| Allowance for loan losses, end of period  | \$ 39,810                         | \$ 38,213 | \$ 37,906                 |  |
| Ratio of allowance for loan losses, end of period, to end of period loans outstanding | 1.06%                             | 1.04%     | 1.03%                     |  |
| Ratio of net charge-offs during the period to average loans outstanding (annualized)  | 0.35%                             | 0.50%     | 0.49%                     |  |

**Legislation and regulation.** ASB is subject to extensive regulation, principally by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). Depending on ASB's level of regulatory capital and other considerations, these regulations could restrict the ability of ASB to compete with other institutions and to pay dividends to its shareholder. See the discussion below under Liquidity and capital resources.

**Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).** Regulation of the financial services industry, including regulation of HEI and ASB, has changed and will continue to change as a result of the enactment of the Dodd-Frank Act, which became law in July 2010. Importantly for HEI and ASB, under the Dodd-Frank Act, on July 21, 2011, all of the functions of the Office of Thrift Supervision transferred to the OCC, the FDIC, the Federal Reserve Board (FRB) and the Consumer Financial Protection Bureau (Bureau). Supervision and regulation of HEI, as a thrift holding company, moved to the FRB, and supervision and regulation of ASB, as a federally chartered savings bank, moved to the OCC. While the laws and regulations applicable to HEI and ASB did not generally change, the applicable laws and regulations are being interpreted, and amended regulations may be or have been adopted, by the Bureau, FRB, and the OCC. HEI will for the first time be

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subject to minimum consolidated capital requirements, and ASB may be required to be supervised through ASHI, its intermediate holding company. The Dodd-Frank Act requires regulators, at a minimum, to apply to bank and thrift holding companies leverage and risk-based capital standards that are at least as strict as those in effect at the insured depository institution level on the date the Act became effective, although there will be a phase-in period for meeting these standards. In addition, HEI will continue to be required to serve as a source of strength to ASB in the event of its financial distress. The Dodd-Frank Act also imposes new restrictions on the ability of a savings bank to pay dividends should it fail to remain a qualified thrift lender.

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More stringent affiliate transaction rules now apply to ASB in the securities lending, repurchase agreement and derivatives areas. Standards were raised with respect to the ability of ASB to merge with or acquire another institution. In reviewing a potential merger or acquisition, the approving federal agency will need to consider the extent to which the proposed transaction will result in greater or more concentrated risks to the stability of the U.S. banking or financial system.

The Dodd-Frank Act established the Bureau; it has authority to prohibit practices it finds to be unfair, deceptive or abusive, and it may also issue rules requiring specified disclosures and the use of new model forms.

ASB may also be subject to new state regulation because of a provision in the Dodd-Frank Act that acknowledges that a federal savings bank may be subject to state regulation and allows federal law to preempt a state consumer financial law on a case by case basis only when (1) the state law would have a discriminatory effect on the bank compared to that on a bank chartered in that state; (2) the state law prevents or significantly interferes with a bank's exercise of its power; or (3) the state law is preempted by another federal law.

The Dodd-Frank Act also adopts a number of provisions that will impact the mortgage industry, including the imposition of new specific duties on the part of mortgage originators (such as ASB) to act in the best interests of consumers and to take steps to ensure that consumers will have the capability to repay loans they may obtain, as well as provisions imposing new disclosure requirements and requiring appraisal reforms. Regulations are required to be adopted within 18 months after the date that is to be specified by the Secretary of the Treasury for the transfer of consumer protection power to the Bureau.

The Durbin Amendment to the Dodd-Frank Act required the FRB to issue rules to ensure that debit card interchange fees are reasonable and proportional to the processing costs incurred. In June 2011, the FRB issued a final rule establishing standards for debit card interchange fees and prohibiting network exclusivity arrangements and routing restrictions. Under the final rule, effective October 1, 2011, the maximum permissible interchange fee that an issuer may receive for an electronic debit transaction is 21-24 cents, depending on certain components. ASB currently earns an average of 50 cents per transaction. As specified in the Dodd-Frank Act, these regulations exempt banks like ASB with less than \$10 billion in assets. However, market pressures could very well push the impact down to all banks.

Many of the provisions of the Dodd-Frank Act, as amended, will not become effective until implementing regulations are issued and effective.

Proposed Capital Rules. The FRB, OCC and FDIC issued three notices of proposed rulemaking (NPR) that would revise and replace the current capital rules. The proposed rules are intended to help ensure banks maintain strong capital positions, which would enable them to continue lending to creditworthy households and businesses even after unforeseen losses and during severe economic downturns.

The first NPR, titled *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions* (Basel III NPR), applies to all depository institutions, bank holding companies with total consolidated assets of \$500 million or more, and savings and loan holding companies and revises the risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision (Basel III). The Basel III NPR would increase the quantity and quality of capital required, revise the definition of capital to improve the ability of regulatory capital instruments to absorb losses, establish limitations on capital distributions and certain discretionary bonus payments if additional specified amounts of common equity tier 1 capital are not met, and introduce a supplementary leverage ratio for internationally active banking organizations. The Basel III NPR would also revise the prompt

corrective action framework by incorporating new regulatory capital minimums and updating the definition of tangible common equity.

The second NPR, titled *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements* (Standardized Approach NPR), proposes to revise and harmonize the rules for calculating risk-weighted assets to enhance risk sensitivity and address weaknesses identified over the past several years. The Standardized Approach NPR would incorporate aspects of the Basel II standardized framework such as methods for determining risk-weighted assets for residential mortgages, securitization exposures, and counterparty credit risk. The Standardized Approach NPR would apply to the same set of institutions as the Basel III NPR, but also introduces disclosure requirements for U.S. banking organizations with \$50 billion or more in assets.

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The third NPR, *Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule: Market Risk Capital Rule* (Advanced Approaches NPR), would apply to banking organizations that are subject to the banking agencies' advanced approaches rule, or to their market risk rule, and revises the advanced approaches risk-based capital rules to be consistent with Basel III and the Dodd-Frank Act. Generally, the advanced approaches rules would apply to institutions with \$250 billion or more in consolidated assets or \$10 billion or more in foreign exposure, and the market risk rule would apply to savings and loan holding companies with significant trading activity.

## Proposed Capital Requirements

| Proposal effective dates                   | 1/1/13                | 1/1/14 | 1/1/15 | 1/1/16 | 1/1/17 | 1/1/18 | 1/1/19 |
|--|-----------------------|--------|--------|--------|--------|--------|--------|
| Capital conservation buffer                |                       |        |        | 0.625% | 1.25%  | 1.875% | 2.50%  |
| Common equity ratio + conservation buffer  | 3.50%                 | 4.00%  | 4.50%  | 5.125% | 5.75%  | 6.375% | 7.00%  |
| Tier 1 capital ratio + conservation buffer | 4.50%                 | 5.50%  | 6.00%  | 6.625% | 7.25%  | 7.875% | 8.50%  |
| Total capital ratio + conservation buffer  | 8.00%                 | 8.00%  | 8.00%  | 8.625% | 9.25%  | 9.875% | 10.50% |
| Countercyclical capital buffer             | not applicable to ASB |        |        |        |        |        |        |
| ASB  |                       |        |        | 0.625% | 1.25%  | 1.875% | 2.50%  |

The final rules are proposed to become effective January 1, 2013. The proposed rules allow for a transition period to meet the proposed capital requirement levels. ASB is reviewing the proposed rules and the impact to its capital ratios. Based on a preliminary assessment, management believes ASB and HEI can satisfy the proposed capital rules that would be applicable to them, if adopted.

**Commitments and contingencies.** See Note 4 of HEI's Notes to Consolidated Financial Statements.

**FINANCIAL CONDITION****Liquidity and capital resources.**

| (dollars in millions)   | September 30, |       | December 31, |       | % change |
|---|---------------|-------|--------------|-------|----------|
|   | 2012          |       | 2011         |       |          |
| Total assets  | \$            | 4,953 | \$           | 4,910 | 1        |
| Available-for-sale investment and mortgage-related securities |               | 664   |              | 624   | 6        |
| Loans receivable held for investment, net                     |               | 3,706 |              | 3,643 | 2        |
| Deposit liabilities   |               | 4,127 |              | 4,070 | 1        |
| Other bank borrowings   |               | 211   |              | 233   | (9)      |

As of September 30, 2012, ASB was one of Hawaii's largest financial institutions based on assets of \$5.0 billion and deposits of \$4.1 billion.



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As of September 30, 2012, ASB's unused FHLB borrowing capacity was approximately \$0.9 billion. As of September 30, 2012, ASB had commitments to borrowers for loan commitments and unused lines and letters of credit of \$1.5 billion. Management believes ASB's current sources of funds will enable it to meet these obligations while maintaining liquidity at satisfactory levels.

For the first nine months of 2012, net cash provided by ASB's operating activities was \$41 million. Net cash used during the same period by ASB's investing activities was \$109 million, primarily due to purchases of investment and mortgage-related securities of \$147 million, a net increase in loans receivable of \$76 million and additions to premises and equipment of \$5 million, partly offset by repayments of investment and mortgage-related securities of \$104 million and proceeds from the sale of mortgage-related securities and real estate acquired in settlement of loans of \$4 million and \$10 million, respectively. Net cash provided in financing activities during this period was \$1 million, primarily due to net increases in deposit liabilities of \$57 million, largely offset by a net decrease in retail repurchase agreements of \$22 million, the payment of \$30 million in common stock dividends to HEI (through ASHI) and a net decrease in mortgage escrow deposits of \$4 million.

FDIC regulations restrict the ability of financial institutions that are not well-capitalized to compete on the same terms as well-capitalized institutions, such as by offering interest rates on deposits that are significantly higher than the rates offered by competing institutions. As of September 30, 2012, ASB was well-capitalized (minimum ratio requirements noted in parentheses) with a leverage ratio of 9.3% (5.0%), a Tier-1 risk-based capital ratio of 11.8% (6.0%) and a total risk-based capital ratio of 12.9% (10.0%). FRB approval is required before ASB can pay a dividend or otherwise make a capital distribution to HEI (through ASHI).

Table of Contents**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company considers interest-rate risk (a non-trading market risk) to be a very significant market risk for ASB as it could potentially have a significant effect on the Company's results of operations and financial condition. For additional quantitative and qualitative information about the Company's market risks, see pages 82 to 85, HEI's Quantitative and Qualitative Disclosures About Market Risk, in Part II, Item 7A of HEI's 2011 Form 10-K and HECO's Quantitative and Qualitative Disclosures About Market Risk, which is incorporated into Part II, Item 7A of HECO's 2011 Form 10-K by reference to Exhibit 99.2.

ASB's interest-rate risk sensitivity measures as of September 30, 2012 and December 31, 2011 constitute forward-looking statements and were as follows:

| Change in interest rates<br>(basis points) | Change in NII<br>(gradual change in interest rates) |                      | Change in EVE<br>(instantaneous change in interest rates) |                      |
|--|---|----------------------|---|----------------------|
|  | September 30,<br>2012                               | December 31,<br>2011 | September 30,<br>2012                                     | December 31,<br>2011 |
| +300                                       | 0.8%  | 0.5%                 | (6.1)%  | (7.4)%               |
| +200                                       | (0.1)   | (0.3)                | (2.7)   | (3.8)                |
| +100                                       | (0.3)   | (0.4)                | (1.0)   | (1.5)                |
| -100                                       | (0.1)   | (0.4)                | (2.9)   | (3.5)                |

Management believes that ASB's interest rate risk position as of September 30, 2012 represents a reasonable level of risk. Net interest income (NII) sensitivity as of September 30, 2012 was less liability sensitive for smaller increases in rates compared to December 31, 2011 due to the lower level of interest rates which increased prepayment forecasts resulting in more assets repricing over a forward-looking 12 months. In the +300 scenario, the interest income benefit from the rate increase is not fully realized until the interest rate on certain loans exceeds their floor rate.

ASB's base economic value of equity (EVE) was \$804 million as of September 30, 2012 compared to \$848 million as of December 31, 2011.

The change in EVE was less sensitive to rising rate scenarios as of September 30, 2012 compared to December 31, 2011 as lower rates led to shorter durations for mortgage-related assets.

The computation of the prospective effects of hypothetical interest rate changes on the NII sensitivity and the percentage change in EVE is based on numerous assumptions, including relative levels of market interest rates, loan prepayments, balance changes and pricing strategies, and should not be relied upon as indicative of actual results. To the extent market conditions and other factors vary from the assumptions used in the simulation analysis, actual results may differ materially from the simulation results. Furthermore, NII sensitivity analysis measures the change in ASB's twelve-month, pre-tax NII in alternate interest rate scenarios, and is intended to help management identify potential exposures in ASB's current balance sheet and formulate appropriate strategies for managing interest rate risk. The simulation does not contemplate any actions that ASB management might undertake in response to changes in interest rates. Further, the changes in NII vary in the twelve-month simulation period and are not necessarily evenly distributed over the period. These analyses are for analytical purposes only and do not represent management's views of future market movements, the level of future earnings, or the timing of any changes in earnings within the twelve month analysis horizon. The actual impact of changes in interest rates on NII will depend on the magnitude and speed with which rates change, actual

changes in ASB's balance sheet, and management's responses to the changes in interest rates.

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**Item 4. Controls and Procedures**

**HEI:**

**Changes in Internal Control over Financial Reporting**

During the third quarter of 2012, there were no changes in internal control over financial reporting identified in connection with management's evaluation of the effectiveness of the Company's internal control over financial reporting as of September 30, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Constance H. Lau, HEI Chief Executive Officer, and James A. Ajello, HEI Chief Financial Officer, have evaluated the disclosure controls and procedures of HEI as of September 30, 2012. Based on their evaluations, as of September 30, 2012, they have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective in ensuring that information required to be disclosed by HEI in reports HEI files or submits under the Securities Exchange Act of 1934:

- (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and
- (2) is accumulated and communicated to HEI management, including HEI's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

**HECO:**

**Changes in Internal Control over Financial Reporting**

During the third quarter of 2012, there were no changes in internal control over financial reporting identified in connection with management's evaluation of the effectiveness of HECO and its subsidiaries' internal control over financial reporting as of September 30, 2012 that has materially affected, or is reasonably likely to materially affect, HECO and its subsidiaries' internal control over financial reporting.

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Richard M. Rosenblum, HECO Chief Executive Officer, and Tayne S. Y. Sekimura, HECO Chief Financial Officer, have evaluated the disclosure controls and procedures of HECO as of September 30, 2012. Based on their evaluations, as of September 30, 2012, they have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective in ensuring that information required to be disclosed by HECO in reports HECO files or submits under the Securities Exchange Act of 1934:

- (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and
- (2) is accumulated and communicated to HECO management, including HECO's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Table of Contents**PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

The descriptions of legal proceedings (including judicial proceedings and proceedings before the PUC and environmental and other administrative agencies) in HEI's Form 10-K (see Part I. Item 3. Legal Proceedings and proceedings referred to therein) and this 10-Q (see Management's Discussion and Analysis of Financial Condition and Results of Operations, Note 4 of HEI's Notes to Consolidated Financial Statements and HECO's Notes to Consolidated Financial Statements) are incorporated by reference in this Item 1. With regard to any pending legal proceeding, alternative dispute resolution, such as mediation or settlement, may be pursued where appropriate, with such efforts typically maintained in confidence unless and until a resolution is achieved. Certain HEI subsidiaries (including HECO and its subsidiaries and ASB) may also be involved in ordinary routine PUC proceedings, environmental proceedings and litigation incidental to their respective businesses.

**Item 1A. Risk Factors**

For information about Risk Factors, see pages 26 to 36 of HEI's 2011 Form 10-K, and Management's Discussion and Analysis of Financial Condition and Results of Operations, Quantitative and Qualitative Disclosures about Market Risk, HEI's Consolidated Financial Statements and HECO's Consolidated Financial Statements herein. Also, see Forward-Looking Statements on pages v and vi of HEI's 2011 Form 10-K, as updated on pages iv and v herein.

**Item 5. Other Information****A. Ratio of earnings to fixed charges.**

|                                    | Nine months ended |      |      | Years ended December 31 |      |      |      |
|------------------------------------|-------------------|------|------|-------------------------|------|------|------|
|                                    | September 30      |      |      | 2010                    | 2009 | 2008 | 2007 |
|                                    | 2012              | 2011 | 2011 |                         |      |      |      |
| HEI and Subsidiaries               |                   |      |      |                         |      |      |      |
| Excluding interest on ASB deposits | 3.75              | 3.16 | 3.22 | 2.89                    | 2.29 | 2.06 | 1.78 |
| Including interest on ASB deposits | 3.56              | 2.97 | 3.03 | 2.64                    | 1.95 | 1.71 | 1.52 |
| HECO and Subsidiaries              | 4.06              | 3.44 | 3.52 | 2.88                    | 2.99 | 3.48 | 2.43 |

See HEI Exhibit 12.1 and HECO Exhibit 12.2.

**B. Indemnity agreement.** In 1989, the board of directors and shareholders of HEI approved a form of Indemnity Agreement (Indemnity Agreement) and authorized HEI to enter into such Indemnity Agreement with all present and future directors and each present and future officer as determined by the board of directors. Later that year, HEI's board of directors authorized HEI to enter into such Indemnity Agreements with

each present and future officer of HEI.

On November 7, 2012, HEI entered into indemnity agreements with each of its directors and the following officers: its President and Chief Executive Officer, Constance H. Lau (also as director); Executive VP, Chief Financial Officer and Treasurer, James A. Ajello; Executive VP, General Counsel, Secretary and Chief Administrative Officer, Chester A. Richardson; and VP-Finance, Controller and Chief Accounting Officer, David M. Kostecki. On the same day, HECO and ASB entered into indemnity agreements with each of their respective directors, including HECO's President and Chief Executive Officer, Richard M. Rosenblum, and ASB's President and Chief Executive Officer, Richard F. Wacker, as directors of their respective companies.

Subject to certain exceptions, the Indemnity Agreement provides that the indemnifying company shall indemnify the indemnitee against all expenses and assessed amounts actually and reasonably incurred by indemnitee in connection with any proceeding arising out of such person's service as an officer, director or agent of the respective company. In addition, the Indemnity Agreement provides for the advancement of expenses incurred by the indemnitee in connection with any covered proceeding. The rights provided by the Indemnity Agreement are in addition to any other rights to indemnification or advancement of expenses to which the indemnitee may be entitled under applicable law, the respective company's articles of incorporation or bylaws, or otherwise.

The foregoing description of the Indemnity Agreement is not complete and is qualified in its entirety by reference to the full text of the form of indemnity agreement filed herewith as HEI Exhibit 10.1 and incorporated herein by reference thereto.

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C. Fuel oil supply contracts. HECO entered into low sulfur fuel oil (LSFO) supply contracts with Chevron Products Company, a Division of Chevron U.S.A. Inc., (Chevron) and Tesoro Hawaii Corporation (Tesoro) for purchases beginning May 1, 2013 since the existing contracts will expire on April 30, 2013. The contract with Chevron was signed and binding as of August 24, 2012, but HECO may terminate the contract by August 31, 2013 if HECO does not receive PUC approval of it by August 31, 2013 or if the PUC's decision is not acceptable to HECO. The foregoing description of the contract with Chevron is not complete and is qualified in its entirety by reference to the full text of the contract with Chevron filed herewith as HECO Exhibit 10.2 and incorporated herein by reference thereto. The contract with Tesoro was executed on August 28, 2012, but will not become effective until the PUC approves the contract. The foregoing description of the contract with Tesoro is not complete and is qualified in its entirety by reference to the full text of the contract with Tesoro filed herewith as HECO Exhibit 10.3 and incorporated herein by reference thereto. Both contracts would provide for slightly higher LSFO pricing than under the respective previous contracts.

HECO, MECO and HELCO executed a Second Amendment to Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract with Tesoro (Second Amendment) to secure a multi-year supply of ultra low sulfur diesel (ULSD) to be consumed in certain reciprocating engine generating units at MECO and HELCO to enable them to comply with the EPA's final rule on Reciprocating Internal Combustion Engines National Emissions Standards for Hazardous Air Pollutants (RICE NESHAP). These units and related fuel distribution infrastructure will begin a transition to ULSD service in the fourth quarter of 2012 in order to achieve compliance with RICE NESHAP by May 2013. HECO is not subject to RICE NESHAP, but was added to the amendment so it can purchase ULSD if necessary. This amendment has been approved by the PUC and became effective October 1, 2012. The foregoing description of the Second Amendment is not complete and is qualified in its entirety by reference to the full text of the Second Amendment filed herewith as HECO Exhibit 10.4 and incorporated herein by reference thereto.



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#### **Item 6. Exhibits**

|                     |  |
|---------------------|--|
| HEI Exhibit 4       | Master Trust Agreement dated as of September 4, 2012 between HEI and ASB and Fidelity Management Trust Company, as Trustee   |
| HEI Exhibit 10.1    | Form of Indemnity Agreement (HEI, HECO and ASB with their respective directors and HEI with certain of its senior officers)  |
| HEI Exhibit 12.1    | Hawaiian Electric Industries, Inc. and Subsidiaries<br>Computation of ratio of earnings to fixed charges, nine months ended September 30, 2012 and 2011 and years ended December 31, 2011, 2010, 2009, 2008 and 2007   |
| HEI Exhibit 31.1    | Certification Pursuant to Rule 13a-14 promulgated under the Securities Exchange Act of 1934 of Constance H. Lau (HEI Chief Executive Officer)  |
| HEI Exhibit 31.2    | Certification Pursuant to Rule 13a-14 promulgated under the Securities Exchange Act of 1934 of James A. Ajello (HEI Chief Financial Officer)   |
| HEI Exhibit 32.1    | HEI Certification Pursuant to 18 U.S.C. Section 1350   |
| HEI Exhibit 101.INS | XBRL Instance Document   |
| HEI Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document  |
| HEI Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| HEI Exhibit 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| HEI Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| HEI Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |
| HECO Exhibit 10.2   | Low Sulfur Fuel Oil Supply Contract by and between Chevron and HECO dated as of August 24, 2012 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly)  |
| HECO Exhibit 10.3   | Supply Contract for Low Sulfur Fuel Oil by and between Tesoro and HECO dated as of August 28, 2012 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly)   |
| HECO Exhibit 10.4   | Second Amendment to Inter-Island Industrial Fuel Oil and Diesel Fuel Supply Contract by and between Tesoro Hawaii Corporation, formerly known as BHP Petroleum Americas Refining Inc., and HECO, MECO and HELCO dated January 31, 2012 (confidential treatment has been requested for portions of this exhibit, which has been redacted accordingly) |
| HECO Exhibit 12.2   | Hawaiian Electric Company, Inc. and Subsidiaries<br>Computation of ratio of earnings to fixed charges, nine months ended September 30, 2012 and 2011 and years ended December 31, 2011, 2010, 2009, 2008 and 2007  |
| HECO Exhibit 31.3   | Certification Pursuant to Rule 13a-14 promulgated under the Securities Exchange Act of 1934 of Richard M. Rosenblum (HECO Chief Executive Officer)   |
| HECO Exhibit 31.4   | Certification Pursuant to Rule 13a-14 promulgated under the Securities Exchange Act of 1934 of Tayne S. Y. Sekimura (HECO Chief Financial Officer)   |
| HECO Exhibit 32.2   | HECO Certification Pursuant to 18 U.S.C. Section 1350  |



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned, thereunto duly authorized. The signature of the undersigned companies shall be deemed to relate only to matters having reference to such companies and any subsidiaries thereof.

**HAWAIIAN ELECTRIC INDUSTRIES, INC.**  
(Registrant)

**HAWAIIAN ELECTRIC COMPANY, INC.**  
(Registrant)

By /s/ Constance H. Lau  
Constance H. Lau  
President and Chief Executive Officer  
(Principal Executive Officer of HEI)

By /s/ Richard M. Rosenblum  
Richard M. Rosenblum  
President and Chief Executive Officer  
(Principal Executive Officer of HECO)

By /s/ James A. Ajello  
James A. Ajello  
Executive Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial Officer of HEI)

By /s/ Tayne S. Y. Sekimura  
Tayne S. Y. Sekimura  
Senior Vice President  
and Chief Financial Officer  
(Principal Financial Officer of HECO)

By /s/ David M. Kostecki  
David M. Kostecki  
Vice President-Finance, Controller  
and Chief Accounting Officer  
(Principal Accounting Officer of HEI)

By /s/ Cathlynn L. Yoshida  
Cathlynn L. Yoshida  
Controller  
(Principal Accounting Officer of HECO)

Date: November 8, 2012

Date: November 8, 2012