

February 16, 2017

## CUC announces its results for the twelve-month period ended December 31, 2016

Caribbean Utilities Company, Ltd. is listed for trading in United States dollars on the Toronto Stock Exchange

**Grand Cayman, Cayman Islands -** Caribbean Utilities Company, Ltd. (TSX: CUP.U) ("CUC" or "the Company") announced today its audited results for the twelve-month period ended December 31, 2016 (all figures in United States dollars).

Net earnings for the year ended December 31, 2016 ("Fiscal 2016") were \$25.2 million, a \$2.4 million increase from net earnings of \$22.8 million for the year ended December 31, 2015 ("Fiscal 2015"). This increase is attributable to a 4% increase in kilowatt-hour ("kWh") sales, 0.9% and 0.1% base rate increases effective June 1, 2015 and June 1, 2016 respectively, lower consumer services expenses and lower finance charges. These items were partially offset by higher depreciation costs.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for Fiscal 2016 were \$24.3 million, or \$0.75 per Class A Ordinary Share as compared to \$21.9 million, or \$0.71 per Class A Ordinary Share for Fiscal 2015. The Company successfully completed a Rights Offering (the "Offering") on May 4, 2015. The Offering raised gross proceeds of \$31,563,639 through the issue of 2,930,700 Class A Ordinary Shares. The weighted average number of Class A Ordinary Shares used to calculate the earnings per Class A Ordinary Share was impacted by the shares issued through the Offering. The full impact of the Rights Offering on the weighted average number of Class A Ordinary Shares would have been experienced during Fiscal 2016, whereas it would have only impacted the latter part of Fiscal 2015.



Electricity sales for Fiscal 2016 were 606.7 million kWh, an increase of 24.7 million kWh or 4% when compared to 582.0 million for Fiscal 2015. Sales were positively impacted by a number of large commercial developments and a 2% growth in overall customer numbers. During 2016 the average monthly kWh consumption rose 6% for residential customers and 2% for commercial customers when compared to 2015.

Electricity sales revenues increased \$3.5 million for Fiscal 2016 to \$80.2 million when compared to electricity sales revenues of \$76.7 million for Fiscal 2015. This increase is primarily attributable to a 4% increase in kWh sales.

President and CEO, Mr. Richard Hew, says, "2016 was a very successful year for CUC. Through the efforts of all of our employees, the Company continued to adequately control its expenses while providing a safe, reliable and efficient service to our customers across Grand Cayman. We are very proud to have reached the milestone of 2 years without a lost time injury ("LTI") on January 27, 2017. This was a notable achievement for the Company's safety record."

The safety of all CUC employees as well as of contractors and members of the public remained a high priority during 2016. Numerous training programmes focused specifically on safety were provided to employees throughout the year.

Electricity consumers continued to enjoy the benefit of lower fuel costs in 2016 driven by a reduction in world market fuel prices as well as the Cayman Islands Government's 30 cent per Imperial Gallon ("IG") reduction in fuel duty effective January 1, 2016. The average Fuel Cost Charge rate per kWh for the twelve months ended December 31, 2016 was \$0.13 per kWh compared to the Fuel Cost Charge rate of \$0.19 per kWh for the twelve months ended December 31, 2015.



Mr. Hew continued, "In June 2016 the Company also completed its largest capital project to date with the commissioning of the new 40 MW power plant, on time and under budget. This plant, one of the most fuel efficient in the region, drove the Company to achieve its highest ever annual net fuel efficiency of 19.0 kWh per IG in 2016. The combination of lower fuel costs and improved fuel efficiency has resulted in savings of \$25.6 million to consumers for the twelve months ended December 31, 2016. At the same time we remain focused on adopting new technologies that are sustainable and environmentally friendly."

The Advanced Metering Infrastructure ("AMI") project was completed during the fourth quarter of 2016. The Smart Meters provide real-time consumption information and also bring efficiencies to meter reading as well as other services. The AMI project will offer a pay-as-you go payment option which will help customers to monitor and control their electricity consumption. This new option will be launched later in 2017.

During 2016, CUC launched the Integrated Resource Plan ("IRP") study. The study analyses all energy resources that are viable and considers their cost, reliability, environmental impact and other aspects and provides a recommended portfolio of energy resources for the market. The Company's goal is to ensure that all energy options are explored before decisions are made on what the grid can accommodate in a safe, reliable and efficient manner. The IRP will give shape to the energy generation and transmission plans for Grand Cayman over the next 30 years.



CUC's 2016 Results and related Management's Discussion and Analysis ("MD&A") for the twelve-month period ended December 31, 2016 are attached to this release and incorporated by reference. They can be accessed by clicking the link at the end of this release.

The MD&A section of this report contains a discussion of CUC's audited 2016 results, the Cayman Islands economy, liquidity and capital resources, capital expenditures and the business risks facing the Company. The release and 2016 MD&A can be accessed at <a href="https://www.cuc-cayman.com">www.cuc-cayman.com</a> (Investor Relations/Press Releases) and at <a href="https://www.sedar.com">www.sedar.com</a>.

CUC provides electricity to Grand Cayman, Cayman Islands, under an Electricity Generation Licence expiring in 2039 and an exclusive Electricity Transmission and Distribution Licence expiring in 2028. Further information is available at <a href="https://www.cuc-cayman.com">www.cuc-cayman.com</a>.

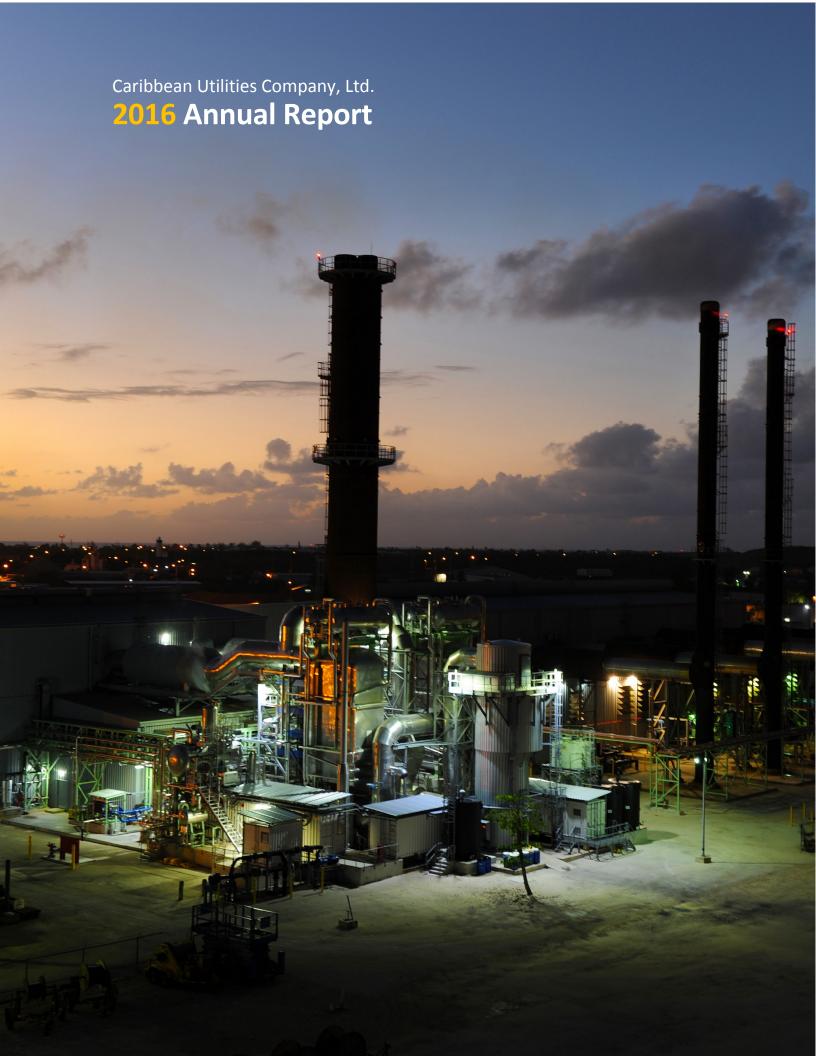
Certain statements in the MD&A, other than statements of historical fact, are forward-looking statements concerning anticipated future events, results, circumstances, performance or expectations with respect to the Company and its operations, including its strategy and financial performance and condition.

Forward looking statements include statements that are predictive in nature, depend upon future events or conditions, or include words such as "expects", "anticipates", "plan", "believes", "estimates", "intends", "targets", "projects", "forecasts", "schedule", or negative versions thereof and other similar expressions, or future or conditional verbs such as "may", "will", "should", "would" and "could". Forward looking statements are based on underlying assumptions and management's beliefs, estimates and opinions, and are subject to inherent risks and uncertainties surrounding future expectations generally that may cause actual results to vary from plans, targets and estimates. Some of the important risks and uncertainties that could affect forward looking statements are described in the MD&A in the section labeled "Business Risks" and include but are not limited to operational, general economic, market and business conditions, regulatory developments and weather. CUC cautions readers that actual results may vary significantly from those expected should certain risks or uncertainties materialize, or should underlying assumptions prove incorrect. Forward-looking statements are provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that such information may not be appropriate for other purposes. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise except as required by law.



Contact: Letitia Lawrence - Vice President Finance and Chief Financial Officer

Phone: (345) 914-1124 E-Mail: <u>llawrence@cuc.ky</u>



## General Data

## **About the Company**

Caribbean Utilities Company, Ltd., known locally as "CUC", commenced operations as the only electric utility in Grand Cayman on May 10, 1966. The Company currently has an installed generating capacity of 161 megawatts ("MW"). The record peak load of 103.4 MW was experienced on July 8, 2016. CUC is committed to providing a safe and reliable supply of electricity to over 28,000 customers. The Company has been through many challenging and exciting periods but has kept pace with Grand Cayman's development for the past 50 years.

## **About the Cayman Islands**

The Cayman Islands, a United Kingdom Overseas Territory with a population of approximately 54,000, are comprised of three islands: Grand Cayman, Cayman Brac and Little Cayman. Located approximately 150 miles south of Cuba, 460 miles south of Miami and 167 miles northwest of Jamaica, the largest island is Grand Cayman with an area of 76 square miles.

A Governor, presently Her Excellency Mrs. Helen Kilpatrick, is appointed by her Majesty the Queen. A democratic society, the Cayman Islands have a Legislative Assembly comprised of representatives elected from each of Grand Cayman's five districts as well as representatives from the Sister Islands of Cayman Brac and Little Cayman.

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 $Readers\ should\ review\ the\ Note\ on\ page\ 11\ in\ this\ Annual\ Report,\ in\ the\ Management's\ Discussion\ and\ Analysis\ section,\ concerning\ the\ use\ of\ forward-looking\ statements,\ which\ applies\ to\ the\ entirety\ of\ this\ Annual\ Report\ to\ shareholders.$ 

## Highlights

Financial Results in Brief						
(Expressed in thousands of United States Dollars unless stated otherwise)						
	Year ended	Year ended				
	December 31,	December 31,				
	2016	2015	Change %			
Operating Revenues	161,702	188,880	-14%			
Electricity Sales Revenues	80,183	76,747	4%			
Fuel Factor	81,519	112,133	-27%			
Total operating expenses	134,802	163,613	-18%			
Finance Charges	6,768	7,301	-7%			
Earnings for the year	25,211	22,842	10%			
Total assets	509,861	482,806	6%			
Total shareholder's equity	220,122	214,489	3%			
Cash from operations	61,739	59,021	5%			
Earnings per Class A Ordinary Share	0.75	0.71	6%			
Dividends per Class A Ordinary Share (paid and declared)	0.675	0.66	0%			
Book value per Class A Ordinary Share	6.74	6.62	2%			
Class A Ordinary Shares						
Market Price: High	13.25	11.80	12%			
Low	10.50	10.30	2%			
Year-end	12.98	11.20	16%			

#### **Performance**

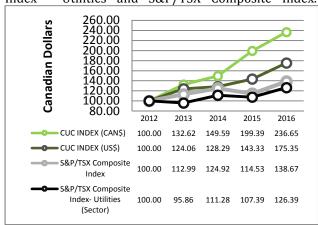
Net earnings for the year ended December 31, 2016 were \$25.2 million. A 4% increase in kilowatt-hour ("kWh") sales, 0.9% and 0.1% base rate increases effective June 1, 2015 and June 1, 2016 respectively, lower consumer service and promotion expenses and interest on long term debt resulted in an increase year-over-year from net earnings of \$22.8 million for the year ended December 31, 2015. Dividends paid and declared on Class A Ordinary Shares were \$0.675 per share. The Class A Ordinary Shares (CUP.U) traded on the Toronto Stock Exchange at a high of \$13.25 per share in 2016.

## **Rate of Exchange**

The closing rate of exchange on December 31, 2016 as reported by the Bank of Canada for the conversion of United States dollars into Canadian dollars was Cdn\$1.3427 per US\$1.00. The official exchange rate for the conversion of Cayman Islands dollars into United States dollars as determined by the Cayman Islands Monetary Authority is fixed at CI\$1.00 per US\$1.20. Thus, the rate of exchange as of December 31, 2016 for conversion of Cayman Islands dollars into Canadian dollars was Cdn\$1.6112 per CI\$1.00 (December 31, 2015: Cdn\$1.6608).

#### **Share Performance**

Comparison of five-year cumulative total returns between Cdn\$100.00 and US\$100.00 invested in CUC Class A Ordinary Shares and the S&P/TSX Composite Index - Utilities and S&P/TSX Composite Index.



Information reflected in this Highlights section should be read in conjunction with the disclosure contained in the following Management's Discussion and Analysis and its associated cautions beginning on page 12. All dollar amounts in this 2016 Annual Report are stated in United States dollars unless otherwise indicated

## Letter to Fellow Shareholders

It is our pleasure to report the financial performance and operational progress of Caribbean Utilities Company, Ltd. ("CUC" or the "Company") for the twelve-month period ended December 31, 2016 ("Fiscal 2016").

#### **Financial Performance**

Net earnings for the year ended December 31, 2016 ("Fiscal 2016") were \$25.2 million, a \$2.4 million increase from net earnings of \$22.8 million for the year ended December 31, 2015 ("Fiscal 2015"). This increase is attributable to a 4% increase in kilowatt-hour ("kWh") sales, 0.9% and 0.1% base rate increases effective June 1, 2015 and June 1, 2016 respectively, lower consumer service and promotion expenses and interest on long term debt. These items were partially offset by higher depreciation.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for Fiscal 2016 were \$24.3 million, or \$0.75 per Class A Ordinary Share as compared to \$21.9 million, or \$0.71 per Class A Ordinary Share for Fiscal 2015. The Company successfully completed a Rights Offering (the "Offering") on May 4, 2015. The Offering raised gross proceeds of \$31,563,639 through the issue of 2,930,700 Class A Ordinary Shares. The weighted average number of shares of Class A Ordinary Shares



used to calculate the earnings per Class A Ordinary Shares for Fiscal 2015 is impacted by the shares issued through the Offering. The full impact of the Rights Offering would have been experienced during Fiscal 2016 whereas it would have only been in place for the later part of Fiscal 2015.

Kilowatt-hour sales for Fiscal 2016 were 606.7 million kWh, an increase of 24.7 million kWh or 4% when compared to 582.0 million for Fiscal 2015. Sales were positively impacted by large commercial development, growth in customer numbers and drier weather conditions.

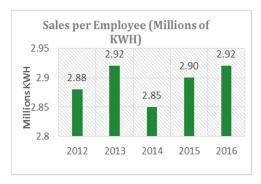
Electricity sales revenue increased \$3.5 million for Fiscal 2016 to \$80.2 million when compared to electricity sales revenues of \$76.7 million for Fiscal 2015. This increase is attributable to a 4% increase in kWh sales

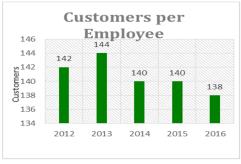
and 0.1% and 0.9% base rate increases effective June 1, 2016 and June 1, 2015 respectively.

## Safety and the Environment

The safety of all of our employees as well as of contractors and members of the public remained a high priority during 2016. Improvements continued on work methods and practices to ensure that jobs were being performed safely. Numerous training programmes which focussed specifically on safety were provided to employees in an effort to keep the workforce safe. Employees took part in an annual Safety Time-Out where targets for health and safety were set and training conducted on completing investigations. The session was aimed at refocusing and reminding employees of the steps they need to take to stay safe on the job.

On January 27, 2017, the Company celebrated 2 years without a lost time injury ("LTI"). This was a notable achievement for the Company's safety record.





The Company hosted its third Contractor's Workshop in 2016. This workshop provided an opportunity for contractors who work around electrical equipment to learn first-hand what safety procedures are required. The workshop also hosted vendors who showcased safety products that are available on Grand Cayman. Representatives from key partners, equipment and service providers participated and made presentations.

CUC held training for First Responders on how to remain safe when dealing with accidents involving electrical components. Members from Hazard Management, 911 Emergency Services, Police Services and the Red Cross attended the training. This was the third time this event was held, and plans are to have this training conducted annually. This training was extended in 2016 to include members of the Hazard Management Community Emergency Response Teams (CERTS) as well as CUC staff.

The Company launched the Move Safe programme in 2015. This programme is aimed at reducing musculoskeletal injuries through teaching staff how to prepare the work area and equipment, and maintain safe posture and movement as they work. In 2016, the programme continued with the training of additional programme leaders. Twenty-two Move Safe leaders have now been trained.

The Company's Environmental Management System ("EMS") successfully passed the surveillance audit of the system in 2016. CUC's EMS is registered to the International Organization for Standardization ("ISO") environmental standard (ISO 14001:2004) which requires that an external audit of the system be conducted on an annual basis. The 2016 external audit showed that the system was in compliance with the standard.

In November 2016, CUC conducted its first internal audit of the occupational health and safety management system (OHSMS) to the OHSAS 18001 standard. The audit was led by an external auditor with a team of trained CUC staff. The audit presents a crucial step towards aligning the Company's OHSMS with that of the OHSAS standard.

2016 marked the third year of the Company's Orange Ribbon Safety Programme. This programme seeks to actively promote and recognize employees who lead the charge for safety in the workplace or who provide solutions to work related problems. Departments are nominated by their Manager and awards are given on a quarterly and annual basis.

## **Capital Projects**

Reliability of service to our customers is a key objective of our Company as it is critical to the quality of life and growth of the economy of Grand Cayman. The Company remains committed to meeting the challenges which come with providing a highly reliable service on a small island such as in Grand Cayman. At the end of 2016, the CUC system Average Service Availability Index was 99.92%.

In June 2016, the Company commissioned its newest power plant, one of the most fuel efficient in the Caribbean. The new engine room houses two 18.5 megawatts ("MW") diesel generating units, one 2.7 MW waste heat recovery steam turbine, and associated auxiliary equipment.

The Company launched the Integrated Resource Plan ("IRP") study in 2016. The study analyses all energy resources that are viable and considers their cost, reliability, environmental impact and other aspects and provides a recommended portfolio of energy resources for the market. The Company's goal is to ensure that all energy options are explored before decisions are made on what the grid can accommodate in a safe, reliable and efficient manner. The IRP will give shape to the energy generation plans for Grand Cayman over the next 30 years.

A committee to establish a National Energy Policy ("NEP") was appointed by the Government in 2010. The goal of the policy is to ensure security, reliability and affordability of energy supplies in the Cayman Islands, as well as to reduce the Islands' carbon footprint and diversify power sources. A draft NEP was issued for discussion in 2013 but was not legislated. In January 2016, the Government appointed a new NEP Review Committee which includes CUC representation. It is the intention of the Cayman Islands Government to pass the National Energy Policy into legislation in 2017.

The Advanced Metering Infrastructure (AMI) project has been completed. The Smart Meters provide real-time consumption information and also brings efficiencies to meter reading as well as other services. The AMI project will offer a pay-as-you go payment option which will help customers to monitor and control their electricity consumption. This new option will be launched in 2017

Capital expenditures for Fiscal 2016 were \$46.5 million, a \$31.5 million, or 40% decrease from \$78.0 million in capital expenditures for the same period of the previous year. The major capital expenditures for Fiscal 2015 were related to the 39.7 MW generation project, the distribution system extension and upgrades, and generation replacement cost.

## **Customer Updates**

Our customer base improved in 2016. Total customers as at December 31, 2016 were 28,678, an increase of 474 compared to 28,204 customers as at December 31, 2015.

With the increased use of technology, the Company has enhanced its service offerings to its customers. Customers now have a number of options to pay their bills outside of CUC's Service Headquarters. These options include gas stations, banks and online payments.

#### **Fuel Price**

With the market price of lubricating and fuel oil trending downwards in 2015, customers saw a significant reduction in the per kWh Fuel Cost Charge on their electricity bills.

The average Fuel Cost Charge rate per kWh charged to consumers for the twelve months ended December 31, 2016 was \$0.13 per kWh compared to the Fuel Cost Charge rate of \$0.19 per kWh for the twelve months ended December 31, 2015. This decrease in the average Fuel Cost Charge rate has resulted in savings of \$25.6 million to consumers for the twelve months ended December 2016. CUC passes through 100% of fuel costs to consumers on a two-month lag basis without mark-up.





The Company's average price per imperial gallon ("IG") of fuel for Fiscal 2016 decreased to \$2.23 from \$2.98 for Fiscal 2015. The Company's average price per IG of lubricating oil for Fiscal 2016 decreased to \$10.36 from \$11.07 for Fiscal 2015.

Fuel factor revenues for Fiscal 2016 totalled \$81.5 million, a \$30.6 million decrease from the \$112.1 million in fuel factor revenues for Fiscal 2015. Fuel factor revenues for Fiscal 2016 decreased when compared to Fiscal 2015 due to a reduction in global oil prices and a reduction in custom duties levied on diesel fuel imports by the Government.

## **Renewable Energy**

The Company continues to facilitate the connecting of renewable energy sources to the grid.

During 2016, Entropy Cayman Solar Limited broke ground for the 5MW solar farm in Bodden Town, the first of its kind in the Cayman Islands. CUC has substantially completed the interconnection facilities for the project including installing a new 13 kiloVolt (KV) line along the Bodden Town bypass road. However, the developer of the project has advised that they are behind schedule. This 5 MW Solar project, now scheduled for completion by Second Quarter 2017, will provide energy to power approximately 800 homes with clean renewable solar energy and will reduce emissions into the atmosphere through the avoidance of diesel fuel consumption.

The Consumer-Owned Renewable Energy Generation ("CORE") programme which allows consumers to generate energy from renewable sources and be compensated through stable, long-term rates continues to attract participants. The programme has proven very popular with residential and commercial customers connecting their solar panels or wind turbines to our grid. At December 31 2016, 181 customers were connected with 2,754.6 kilowatts ("kW") of renewable capacity.

The Company anticipates further renewable energy sources will be connected to the grid with a Request for Proposal ("RFP") for renewable energy being conducted by the Electricity Regulatory Authority ("ERA") in the near future.

## **Human Resources and Training**

The Company's continued commitment to developing and enhancing the skill level of all employees was evident in 2016. Over 7,098 hours were devoted to the training and development of staff to perform their jobs in a safe and efficient manner as well as to improve performance and skills. A major focus for 2016 was to support CUC's leadership development framework. This was achieved through the launch of the Institute of Leadership and Management ("ILM") certificate programme for those at the Foreman, Supervisor, and Manager levels. On completion of the programme, the participants are expected to have enhanced their management and business acumen skills. During the year in review, the company was able to establish a secondment program with Tucson Electric Power ("TEP") a Fortis subsidiary, in which Mr. Corey Miller, an Engineer-in-training, will spend 12 months obtaining valuable experience to keep abreast of industry best practices and new technologies.

CUC employs 208 full-time employees, approximately 86% of whom are Caymanians. Throughout 2016, the Company remained committed to its training programmes, which provided Caymanian employees with the training necessary to excel in their respective fields and to ensure their advancement within the organization. This commitment and training resulted in the promotion of 28 employees to positions of increased responsibility.

CUC's scholarship programme forms part of the Company's continued commitment to the development of the young people of the Cayman Islands. During 2016, the Company awarded two 'A' level scholarships for local study, and three university scholarships to James Ebanks, Andrew Green, and Bianca Christian, the first female to receive a scholarship in the field of Engineering.

The Company also focused on strengthening its performance management system, ensuring that goals and objectives were set for each employee and that two performance reviews were conducted for each employee during the year.

Twenty-seven employees received long service awards for having careers spanning from 10 years to 40 years. Together, they gave the Company 485 years of service. We are grateful to them for the significant contribution they made to the Company over the years.

## **Community Involvement**

The Community Involvement Programme provides the opportunity for a wide cross section of the Company's employees to give of their time and talent to the Cayman community through volunteerism.

At the end of December 2016, employees had volunteered over 1,800 hours participating in a number of the Company's Community Involvement projects. These included Meals on Wheels, CUC's Primary Football League ("PFL"), the Cayman Islands Scout Association and Positive Intervention Now ("PIN"), an afterschool programme. The Company continues to sponsor a Mangrove Environmental Education Programme, which exposes primary school children to Grand Cayman's marine environment. The Company provides support to the Lighthouse School and the Sunrise Adult Training Centre, two facilities which cater to adults and children with special needs, and also continues to support local sports. CUC remains committed to the ongoing development of the community in which we live and work.

## **Summary**

On May 10, 2016, the Company celebrated 50 years of operating in Grand Cayman. Over this time period, we have seen CUC grow from 650 customers to over 28,000 customers and from a peak demand of 0.9 MW to 103.4 MW as recorded in July 2016.

During 2016, the golden anniversary year, the Company celebrated the momentous milestone through various events which included Customer Appreciation days and the presentation of donations to five local charities.

The Company also co-hosted the CARILEC CEO and Finance Conference, which attracted many CEOs and CFOs from utility companies throughout the region with the theme "Power. People. Partnership". This conference gave delegates the opportunity to debate the issues relevant to utilities companies and discuss ways to improve operations within the region. Some of the highlight presentations and discussions included: 'Reinventing your Utility's Culture and Personality: Managing Power and Politics', 'Enabling the Safe, Secure and Energy Efficient Smart Cities of Tomorrow', and 'Utilities and Smart Cities in the 21st Century'.

During 2016, the Cayman Islands Government passed legislation to facilitate the reform of the regulatory arrangements in the utilities sector merging the Electricity Regulatory Authority ("ERA") and the Information and Communications Technology Authority ("ICTA") The newly merged entity is called the Utility Regulation and Competition Office ("OfReg") The government anticipates that the combination of resources will provide greater depth of collaborative utilities regulation, which will result in increased efficiency and effectiveness in regulatory processes, inspire confidence and predictability in a unified regulator, encourage competition where appropriate and feasible, champion sustainability and innovation across markets and contribute to the economic and social goals of the Cayman Islands. This change in the legislation will not materially affect CUC's Licences.

Work continues on the expansion of the Owen Roberts International Airport. This project is scheduled to be completed by 2018. The new design will expand the current facility to feature a larger terminal that will accommodate the projected growth in air arrivals.

The 265-room Kimpton Seafire Resort and Spa was officially opened in November 2016. These new large commercial development projects augur well for the local economy as they create additional employment opportunities and an increase in stay over tourism.

The ESO also issued the 2016 Semi-Annual Economic Report in October 2016. The report indicated that the Gross Domestic Product ("GDP") expanded by an estimated 3.0% in the first six months of 2016. The expanding sectors were led by construction, utilities, wholesale and retail trade, transport, storage and communication, financing and insurance services. The ESO is forecasting Annual GDP growth in 2016 of 3.0% with the increase in construction activity and increased lending activity from commercial banks expected to continue for the second half of the year.

Both air and cruise arrivals for 2016 were comparable to 2015. Air arrivals have a direct impact on the Company's sales growth as these visitors are stay-over visitors who occupy the hotels. Cruise arrivals have an indirect impact as they affect the opening hours of the establishments operating for that market.

In 2016 Mr. Sacha Tibbetts was promoted to the executive level as Vice President, Customer Service and Technology. Sacha's appointment to this new role solidifies our Executive team structure and will better position our company to deliver on our key strategic initiatives which include Reliability, New Business and Technology, Human Capital and Brand.

The Company also congratulates Ms. Briony Gallegos on being the 2016 winner of the President's Award, Ms. Cindy Powell, the Supervisor of the year and Mr. Jarron Conolly, the Excellence in Safety Award winner, a new individual award for Safety Excellence which was introduced in 2016. We are very proud of these employees and their achievements.

The Board of Directors continue to provide guidance and support and we thank them for their ongoing contributions. We are also thankful to our loyal and dedicated employees who remain committed to our mission which is "To be a leader in the growth of our community by delivering safe and reliable energy service at competitive costs and with respect to the environment while remaining a model corporate citizen and providing a fair return to our shareholders."

David E. Ritch, OBE, IP

Chairman of the Board of Directors

J.F. Richard Hew

President & Chief Executive Officer

February 13, 2017

## Management's Discussion and Analysis



The following management's discussion and analysis ("MD&A") should be read in conjunction with the Caribbean Utilities Company, Ltd. ("CUC" or the "Company") consolidated financial statements for the year ended December 31, 2016 ("Fiscal 2016"). The material has been prepared in accordance with National Instrument 51-102 - Continuous Disclosure Obligations ("NI 51-102") relating to Management's Discussion and Analysis.

Additional information in this MD&A has been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP"), including certain accounting practices unique to rate-regulated entities. These accounting practices, which are disclosed in the notes to the Company's 2016 annual financial statements, result in regulatory assets and liabilities which would not occur in the absence of rate regulation. In the absence of rate regulation, the amount and timing of recovery or refund by the Company of costs of providing services, including a fair return on rate base assets, from customers through appropriate billing rates would not be subject to regulatory approval.

Certain statements in this MD&A, other than statements of historical fact, are forward-looking statements concerning anticipated future events, results, circumstances, performance or expectations with respect to the Company and its operations, including its strategy and financial performance and condition. Forward looking statements include statements that are predictive in nature, depend upon future events or conditions, or include words such as "expects", "anticipates", "plan", "believes", "estimates", "intends", "targets", "projects", "forecasts", "schedule", or negative versions thereof and other similar expressions, or future or conditional verbs such as "may", "will", "should", "would" and "could". Forward-looking statements are based on underlying assumptions and management's beliefs, estimates and opinions, and are subject to inherent risks and uncertainties surrounding future expectations generally that may cause actual results to vary from plans, targets and

estimates. Some of the important risks and uncertainties that could affect forward looking statements are described in the MD&A in the sections labelled "Business Risks", "Capital Resources" and "Corporate and Regulatory Overview" and include but are not limited to operational, general economic, market and business conditions, regulatory developments and weather. CUC cautions readers that actual results may vary significantly from those expected should certain risks or uncertainties materialize, or should underlying assumptions prove incorrect. Forward-looking statements are provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that such information may not be appropriate for other purposes. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise except as required by law.

Financial information is presented in United States dollars unless otherwise specified. The consolidated financial statements and MD&A in this annual report were approved by the Audit Committee.

February 13, 2017

Financial	l and Opera	tional Hig	hlights

(\$ thousands, except basic earnings per ordinary share, dividends paid per ordinary share and where otherwise indicated)

	Year Ended	Year Ended	Change	% Change
	December 31,	<b>December 31, 2015</b>	· ·	· ·
	2016			
Electricity Sales Revenues	80,183	76,747	3,436	4%
Fuel Factor Revenues	81,519	112,133	(30,614)	-27%
Operating Revenues	161,702	188,880	(27,178)	-14%
Fuel and Lube Costs	81,519	112,133	(30,614)	-27%
Other Operating Expenses	53,283	51,480	1,803	4%
Total Operating Expenses	134,802	163,613	(28,811)	-18%
Earnings for the Period	25,211	22,842	2,369	10%
Cash Flow from Operating Activities	61,739	59,021	2,718	5%
Per Class A Ordinary Share:				
Basic Earnings	0.75	0.71	0.04	6%
Dividends Paid	0.675	0.660	0.015	2%
Total Customers	28,678	28,204	474	2%
Total Employees*	208	201	7	3%
Customer per Employee (#)	138	140	-2	-1%
System Availability (%)	99.92	99.96	(-0.04)	0%
Peak Load Gross (MW)	103.4	100.7	2.7	3%
Millions of kWh:	_			
Net Generation	650.28	623.7	26.6	4%
Kilowatt-Hour Sales	606.70	582.0	24.7	4%
Sales per employee	2.92	2.90	0.02	1%

<sup>\*</sup> Total Full time CUC employees

## **Corporate and Regulatory Overview**

The principal activity of the Company is to generate, transmit and distribute electricity in its licence area of Grand Cayman, Cayman Islands pursuant to a 20-year exclusive Transmission & Distribution ("T&D") Licence and a 25-year non-exclusive Generation Licence (the "Licences") granted by the Cayman Islands Government (the "Government"), which expire in April 2028 and November 2039, respectively.

The Licences contain the provision for a rate cap and adjustment mechanism ("RCAM") based on published consumer price indices. CUC's return on rate base ("RORB") for 2016 was 7.4% (2015: 7.4%). CUC's RORB for 2017 is targeted in the 6.75% to 8.75% range (2016: 6.75% to 8.75%).

CUC's base rates are designed to recover all non-fuel and non-regulatory costs and include per kilowatt-hour ("kWh") electricity charges and fixed facilities charges. Fuel cost charges and regulatory fees are billed as separate line items. Base rates are subject to an annual review and adjustment each June through the RCAM. In June 2016, following review and approval by the Electricity Regulatory Authority ("ERA"), the Company increased its base rates by 0.1%. This increase was a result of the 2015 RORB and the increase in the applicable United States ("US") and Cayman Islands consumer price indices, adjusted to exclude food and fuel, for calendar year 2015. The change in the base rates as a percentage of the US and Cayman Islands consumer price indices was 80% based on the range of the RORB values. The required rate adjustment of 0.9% can be calculated by applying 80% to the total price level index (60% of the Cayman Islands CPI and 40% of the US CPI) of 0.12%. All fuel and lubricating oil costs are passed through to customers without markup as a per kWh charge. Rate base is the value of capital upon which the Company is permitted an opportunity to earn a return. The value of this capital is the average of the beginning and ending values for the applicable financial year of: fixed assets less accumulated depreciation, plus the allowance for working capital, plus regulatory assets less regulatory liabilities.

The ERA has the overall responsibility for regulating the electricity industry in the Cayman Islands in accordance with the ERA Law. The ERA oversees all licencees, establishes and enforces licence standards, enforces applicable environmental and performance standards, reviews the proposed RCAM, and sets the rate adjustment factors as appropriate.

In December 2016 the ERA approved CUC's 2017-2021 Capital Investment Plan in the amount of \$219 million (December 2015 approved amount: 2016-2020: \$204 million).

In June 2016, the Company commissioned its newest power plant, one of the most fuel efficient in the Caribbean. The new engine room houses two 18.5 megawatts ("MW") diesel generating units, one 2.7 MW waste heat recovery steam turbine, and associated auxiliary equipment.

The total project cost for the 40 MW power plant was estimated at \$85 million and the actual overall cost was \$79.0 million. A total of \$11.6 million was spent in 2014, an additional \$47.9 million was spent on the project during the year ended December 31, 2015 and \$19.5 million was spent during 2016. This positive variance in actual cost compared to the bid is due primarily to a favourable exchange rate on the EURO portion of the MAN/BWSC contract and a shortened construction period resulting in lower financing costs. The project was completed in eighteen months, compared to an original estimated construction period of twenty-four months.

A licence fee of 1%, payable to the Government, is charged on gross revenues, then prorated and applied only to customer billings with consumption over 1,000 kWh per month as a pass-through charge. In addition to the licence fee, a regulatory fee of  $\frac{1}{2}$  of 1% is charged on gross revenues, then prorated and applied only to customer billings with consumption over 1,000 kWh per month.

In the event of a natural disaster as defined in the T&D Licence, the actual increase in base rates will be capped for the year at 60% of the change in the Price Level Index and the difference between the calculated rate increase and the actual increase expressed as a percentage, shall be carried over and applied in addition to the normal RCAM adjustment in either of the two following years if the Company's RORB is below the target range. In the event of a disaster the Company would also write-off destroyed assets over the remaining

life of the asset that existed at time of destruction. Z Factor rate changes will be required for insurance deductibles and other extraordinary expenses. The Z Factor is the amount, expressed in cents per kWh, approved by the ERA to recover the costs of items deemed to be outside of the constraints of the RCAM.

Performance standards provide a balanced framework of potential penalties or rewards compared to historical performance in the areas of planning, reliability, operating and overall performance. Standards include "zones of acceptability" where no penalties or rewards would apply. In April 2015, the ERA approved a reward related to the Company's performance for 2013-2014 in accordance with the T&D Licence. The total performance reward of \$0.05 million was applied to customer billings as a per kWh charge on a one time-basis in June 2015.

CUC's wholly-owned subsidiary, DataLink, Ltd. ("DataLink"), was granted a licence in 2012 from the Information and Communications Technology Authority ("ICTA") permitting DataLink to provide fibre optic infrastructure and other information and communication technology ("ICT") services to the ICT industry. The term of the licence is 15 years and expires on March 27, 2027. CUC and DataLink have entered into three ERA-approved agreements:

- 1. The Management and Maintenance agreement;
- 2. The Pole Attachment agreement; and
- 3. The Fibre Optic agreement

### **Consolidation Accounting Policy**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary DataLink. All significant intercompany balances and transactions have been eliminated on consolidation.

## **Earnings**

Net earnings for the year ended December 31, 2016 ("Fiscal 2016") were \$25.2 million, a \$2.4 million increase from net earnings of \$22.8 million for the year ended December 31, 2015 ("Fiscal 2015"). This increase is attributable to a 4% increase in kWh sales, 0.9% and 0.1% base rate increases effective June 1, 2015 and June 1, 2016 respectively, lower consumer service and lower finance charges. These items were partially offset by higher depreciation.

Finance charges for Fiscal 2016 totalled \$6.8 million, a \$0.5 million decrease from \$7.3 million for Fiscal 2015. This decrease is as a result of higher Allowance for Funds Used during Construction ("AFUDC") driven by the Company's 39.7 MW Generation Project (see the "Other Income and Expenses" section of this MD&A for further details).

Other income totalled \$3.9 million for Fiscal 2016, an increase of \$0.5 million when compared to other income of \$3.4 million for Fiscal 2015. The Company's Customer Service Code ("CSC") which allows for additional service fees became effective on January 1, 2015 (see the "Other Income and Expenses" section of this MD&A for further details).

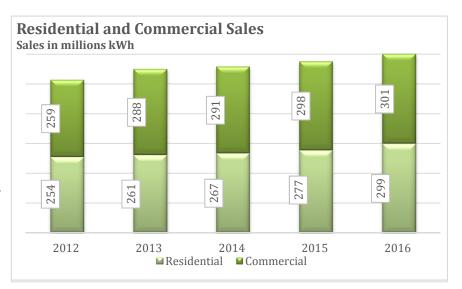
After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for Fiscal 2016 were \$24.3 million, or \$0.75 Class A Ordinary Share as compared to \$21.9 million, or \$0.71 per Class A Ordinary Share for Fiscal 2015. The Company calculates earnings per share on the weighted average number of Class A Ordinary Shares outstanding. The weighted average Class A Ordinary Shares outstanding were 32,483,387 and 31,041,240 for the years ended December 31, 2016 and December 31, 2015, respectively.

The Company successfully completed the Offering on May 4, 2015. The shares issued as part of the offering impacted the weighted average number of Class A Ordinary Shares used to calculate the earnings per Class A Ordinary Shares for Fiscal 2015.

## **Sales**

Sales for Fiscal 2016 were 606.7 million kWh, an increase of 24.7 million kWh or 4% when compared to 582.0 million for Fiscal 2015. Sales were positively impacted by a number of large commercial development and a 2% growth in customer numbers.

Total customers as at December 31, 2016 were 28,678, an increase of 474 compared to 28,204 customers as at December 31, 2015.



#### **Operating Revenues**

Operating revenues Fiscal 2016 totalled \$161.7 million, a decrease of \$27.2 million from \$188.9 million Fiscal 2016. This for decrease operating in revenues was due to lower fuel factor revenues partially offset by higher electricity sales revenues.

Electricity sales revenue increased \$3.5 million for Fiscal 2016 to \$80.2 million when compared to electricity sales revenues of \$76.7 million for Fiscal 2015. This increase is attributable to a 4% increase in kWh sales and the 0.1% and 0.9% base rate increases effective June 1, 2016 and June 1, 2015 respectively.

Fuel factor revenues for Fiscal 2016 totalled \$81.5 million, a \$30.6 million decrease from the \$112.1 million in fuel factor revenues for Fiscal 2015.

Sales and Customer Highlights			
	Year Ended December 31, 2016	Year Ended December 31, 2015	Change %
Customers (number)			
Residential	24,429	24,007	2%
Commercial	4,249	4,197	1%
Total Customers	28,678	28,204	2%
Sales (in thousands kWh)			
Residential	299,079	276,944	8%
Commercial	300,825	298,285	1%
Other	6,795	6,748	1%
Total Sales	606,699	581,977	4%
Average Monthly Consumption Per Customer (kWh)			
Residential	1,030	968	6%
Commercial	58,715	57,740	2%
Revenues (in thousands of \$)			
Residential	38,881	35,948	8%
Commercial	40,642	40,060	1%
Other (street lights etc.)	660	739	-11%
Fuel Factor	81,519	112,134	-27%
Total Operating Revenues*	161,702	188,881	-14%
*Total CUC Customers and Revenue Only			

The average Fuel Cost Charge rate per kWh charged to consumers for the year ended December 31, 2016 was \$0.13 compared to the Fuel Cost Charge rate of \$0.19 per kWh for the year ended December 31, 2015. In June 2016 the Company also completed its largest capital project to date with the commissioning of the new 40 MW power plant, on time and under budget. This plant, one of the most fuel efficient in the region, drove the Company to achieve its highest ever annual net fuel efficiency of 19.0 kWh per IG in 2016. This decrease in the average Fuel Cost Charge rate has resulted in savings of \$25.6 million to consumers for the year ended December 31, 2016 when compared to the year ended December 31, 2015. Fuel factor revenues for Fiscal 2016 decreased when compared to Fiscal 2015 due to a reduction in global oil prices and a reduction in custom duties levied on diesel fuel imports by the Government. In 2016, the Government reduced custom duties levied on diesel fuel imports by \$0.30 per imperial gallon ("IG").

## **Operating Expenses**

Total operating expenses for Fiscal 2016 decreased \$134.8 million to \$28.8 million from \$163.6 million for Fiscal 2015. The main contributing factors to the decrease in operating expenses were lower fuel costs, improved fuel efficiency and consumer services and promotion costs partially offset by higher depreciation and amortization expenses.

Operating expenses were as follows:

Operating Expenses				
(\$ thousands)				
	Year Ended	Year Ended	Change	% Change
	December 31,	December 31, 2015		
	2016			
Power Generation Expenses	85,271	116,105	(30,834)	-27%
General and Administration	8,691	9,134	(443)	-5%
Consumer Service	2,318	3,212	(894)	-28%
Transmission and Distribution	2,904	2,853	51	2%
Depreciation	29,257	25,961	3,296	13%
Maintenance	5,736	5,861	(125)	-2%
Amortization of Intangible Assets	<u>625</u>	<u>487</u>	<u>138</u>	28%
Total Operating Expenses	134,802	163,613	(28,811)	-18%

#### **Power Generation**

Power generation costs for Fiscal 2016 totalled to \$85.3 million, a \$30.8 million or 27% decrease when compared to \$116.1 million for Fiscal 2015. This decrease is as a result of lower fuel costs.

Power generation expenses were as follows:

Power Generation							
(\$ thousands) Fuel and Lubricating Oil costs stated net of deferred charges							
	Year Ended	Year Ended	Change	% Change			
	December 31,	December 31,					
	2016	2015					
Fuel costs (net of deferred fuel charges)	79,480	110,067	(30,587)	-28%			
Lubricating Oil costs (net of deferred lubricating oil							
charges)	2,039	2,066	(27)	-1%			
Temporary generation costs	364	707	(343)	-49%			
Other generation expenses	<u>3,388</u>	<u>3,265</u>	<u>123</u>	4%			
Total Power Generation expenses	85,271	116,105	(30,834)	-27%			

The Company's average price per IG of fuel for Fiscal 2016 decreased to \$2.23 from \$2.98 for Fiscal 2015. The Company's average price per IG of lubricating oil for Fiscal 2016 decreased to \$10.36 from \$11.07 for Fiscal 2015.

Net generation was 650.3 million kWh for Fiscal 2016 compared to 623.7 million kWh for Fiscal 2015. Net fuel efficiency for Fiscal 2016 of 19.02 kWh per IG increased when compared to net fuel efficiency for Fiscal 2015 of 18.28 kWh per IG. This increase in net fuel efficiency is due primarily to the new generating units installed in 2016 and decrease in the usage of the temporary mobile generation.

The Fuel Tracker Account (see Note6 of the Notes to Annual Consolidated Financial Statements for further details) is comprised of total diesel fuel and lubricating oil costs to be recovered from consumers.

In March 2011, the ERA approved the Fuel Price Volatility Management Programme. The objective of the programme is to reduce the impact of volatility in the Fuel Cost Charge paid by the Company's customers for the fuel that the Company must purchase in order to provide electric service. Contracts initiated in 2015 utilize call options and call spreads to promote transparency in pricing. The monthly hedging costs and returns are also included within the Fuel Tracker Account.

Temporary generation expenses for Fiscal 2016 totalled \$0.4 million, a decrease of \$0.3 million when compared to temporary generation expenses for Fiscal 2015 of \$0.7 million. All temporary generating units had been returned to the supplier in June 2016.

Other generation expenses for Fiscal 2016 totalled \$3.4 million, an increase of \$0.1 million when compared to \$3.3 million for Fiscal 2015.

## General and Administration ("G&A")

G&A expenses for Fiscal 2016 totalled \$8.7 million, a decrease of \$0.4 million, from \$9.1 million for Fiscal 2015. This decrease was due mainly to lower other employee benefits costs, lower Performance Share Unit ("PSU") plan costs (see Note 13 in the Notes to the Annual Consolidated Financial Statements) and lower insurance premiums. These decreases were partially offset by higher public relations costs and an increase in temporary staff costs in 2016.

The Company capitalizes certain overhead costs not directly attributable to specific capital assets but which do relate to the overall capital expenditure programme. GEC totalled \$4.3 million for Fiscal 2016, \$0.1 million higher than \$4.2 million for Fiscal 2015.

#### Consumer Services ("CS")

CS expenses for Fiscal 2016 totalled \$2.3 million, a decrease of \$0.9 million when compared to \$3.2 million for Fiscal 2015. This decrease is attributable to a decrease in the allowance for doubtful accounts ("AFDA") recorded in 2016.

In accordance with its AFDA policy, the Company maintains an accumulated provision for uncollectible customer accounts receivable that is estimated based on known accounts, historical experience and other currently available information, including the economic environment. During 2014, the Company completed a full review of its outstanding accounts receivables balance and the reasonableness of its methodology of applying a flat percentage to total receivables in calculating AFDA. This review indicated an increase in days outstanding for receivable balances. Consequently, management determined the estimation process related to the AFDA would be refined to include a risk element for aging of accounts receivable. The AFDA policy was enacted in Fiscal 2015 and the AFDA expense was higher in Fiscal 2015 due to it being the first year of implementation. During Fiscal 2016, the Company has been actively monitoring receivables and enforcing the Customer Service Code ("CSC").

Trade and other accounts receivable		
(\$ thousands)		
	As at December	As at December
	31, 2016	31, 2015
Current	6,552	8,160
Past due 31-60 days	592	1,018
Past due 61-90 days	153	240
Past due over 90 days	<u>5,073</u>	<u>4,313</u>
Total Accounts Receivable	12,370	13,731
Less: Allowance for doubtful accounts	(1,987)	(1,964)
Less: Consumer Deposits	<u>(7,754)</u>	(6,823)
Trade receivables less allowance for doubtful accounts and consumer deposits	2,629	4,944

Trade receivables less allowance for doubtful accounts and consumer deposits as at December 31, 2016 totalled \$2.6 million, a decrease of \$2.3 million, or 47% when compared to the Net Exposure of \$4.9 million as at December 31, 2015. This decrease was primarily related to a decrease in customer receivables and an increase in consumer deposits. Customer receivables decreased by \$1.6 million due mainly to the reduction in the fuel factor billed to consumers and improved efficiencies in the disconnection process resulting from the newly installed Advanced Metering Infrastructure ("AMI") meters. At the end of December 2016, 97% of the planned AMI installations were completed. Customers who have had the AMI meters installed are benefiting from the ability to monitor their consumption and manage their usage.

## Transmission and Distribution ("T&D")

T&D expenses for Fiscal 2016 totalled \$2.9 million comparable to T&D expenses of \$2.9 million for Fiscal 2015.

## Depreciation of Property, Plant and Equipment ("Depreciation")

Depreciation expenses for Fiscal 2016 totalled \$29.3 million, an increase of \$3.3 million, or 13%, from \$26.0 million for Fiscal 2015. This increase in depreciation is due to completed capital projects, including the 39.7 MW generation project.

## Maintenance

Maintenance expenses for Fiscal 2016 totalled \$5.7 million, a decrease of \$0.2 million from \$5.9 million for Fiscal 2015.

This decrease is due to the maintenance department's focus on higher portion of maintenance of a capital nature during Fiscal 2016.

#### **Amortization**

Amortization of intangible assets for Fiscal 2016 totalled \$0.6 million, an increase of \$0.1 million when compared to \$0.5 million for Fiscal 2015.

Amortization represents the monthly recognition of the expense associated with software purchases as well as other intangible assets such as the costs associated with the licence negotiations. The negotiations for the Company's electricity licence concluded in 2008 and the costs associated with the negotiations are being amortized over 20 years on a straight-line basis. The negotiations associated with DataLink's ICT licence ceased in 2012 and these costs are being amortized over 15 years on a straight-line basis.

#### **Other Income and Expenses**

Net Other Expenses for Fiscal 2016 totalled \$1.7 million, a decrease of \$0.7 million from \$2.4 million for Fiscal 2015.

Other Income & Expenses				
(\$ thousands)				
	Year Ended	Year Ended	Change	% Change
	December 31,	December 31,		
	2016	2015		
Total interest costs	(12,170)	(12,629)	459	-4%
AFUDC	<u>5,402</u>	<u>5,328</u>	<u>74</u>	1%
Total finance charges	(6,768)	(7,301)	533	-7%
Foreign exchange gain	1,158	1,435	(277)	-19%
Other income	<u>3,921</u>	<u>3,441</u>	<u>480</u>	14%
Total Net Other Expense	(1,689)	(2,425)	736	-30%

Finance charges for Fiscal 2016 totalled \$6.8 million, a decrease of \$0.5 million from \$7.3 million for Fiscal 2015. This decrease is as a result of lower interest on long term debt, partially offset by higher interest costs on short term debt.

Under the T&D Licence there is a provision for an Allowance for Funds Used During Construction ("AFUDC"). This capitalisation of the Financing Cost is calculated by multiplying the Company's Cost of Capital rate by the average work in progress for each month. The cost of capital rate for 2016 was 7.75% (2015:8.25%) as agreed with the ERA, in accordance with the T&D Licence, and is reviewed annually.

The AFUDC amount for Fiscal 2016 totalled \$5.4 million, a \$0.1 million increase when compared to \$5.3 million for Fiscal 2015. This increase was attributable to higher average work in progress, driven primarily by the generation expansion project.

Foreign exchange gains and losses are the result of monetary assets and liabilities denominated in foreign currencies that are translated into United States dollars at the exchange rate prevailing on the Balance Sheet date. Revenue and expense items denominated in foreign currencies are translated into United States dollars at the exchange rate prevailing on the transaction date. Foreign exchange gains totalled \$1.2 million for Fiscal 2016 a \$0.2 million decrease when compared to \$1.4 million for Fiscal 2015. Foreign exchange gains have decreased due to the decline in global oil prices which result in lower fuel purchases.

Other income is comprised of income from the third party customers of DataLink, income from pipeline operations, sale of meter sockets, sale of recyclable materials, performance rewards as part of the T&D Licence and other miscellaneous income. Performance standards as prescribed by the T&D Licence provide a balanced framework of potential penalties or rewards compared to historical performance in the areas of planning, reliability, operating and overall performance. Standards include "zones of acceptability" where no penalties or rewards would apply.

Other income totalled \$3.9 million for Fiscal 2016, an increase of \$0.5 million when compared to other income of \$3.4 million for Fiscal 2015. The Company's new Customer Service Code ("CSC") became effective on January 1, 2015. The CSC sets out the terms and conditions of the supply of electricity to the Company's customers, as well as the standards for the level of service which CUC is required to provide to its customers.

The new CSC also provides for an increase in various customer service fees such as reconnection fees and the introduction of late fees on outstanding customer receivables.

Revenues from DataLink for Fiscal 2016 are recorded in Other Income in the amount of \$1.7 million, an increase of \$0.7 million, from \$1.0 million for Fiscal 2015. The increase is due to the increase in one time pole attachment fees in arrears.

#### The Economy

The Cayman Islands Economics and Statistics Office ("ESO") released the Consumer Price Index ("CPI") report for the Third Quarter in November 2016. According to the report, the CPI for the Third Quarter increased by 0.5% compared to Third Quarter 2015. This increase is as a result of increases in the prices for restaurants and hotels, recreation and culture, education, housing and utilities, alcohol and tobacco and communication. Prices for transport, health, household equipment, clothing and footwear and miscellaneous goods and services declined. The ESO is forecasting 2016 annual inflation of 0.5%.

The ESO also issued the 2016 Semi-Annual Economic Report in October 2016. The report indicated that the Gross Domestic Product ("GDP") expanded by an estimated 3.0% in the first six months of 2016. The expanding sectors were led by construction, utilities, wholesale and retail trade, transport, storage and communication, financing and insurance services.

The ESO is forecasting Annual GDP growth in 2016 of 3.0% with the increase in construction activity and increased lending activity from commercial banks expected to continue for the second half of the year.

The financial services sector continues to experience its challenges. Overall, there were fewer bank licences, mutual funds, registered companies and captive insurance companies when compared to the prior year. Despite the downward trends, the Cayman Islands continue to be one of the world's largest banking sectors in terms of assets and one of the top jurisdictions for captive insurance companies in terms of the number of captive insurance companies and total assets under management.

The table below itemises trends in some of the key financial areas.

Indicators for the Financial Services Industry						
(for the years ending December 31)						
	2016	2015	2014	2013	2012	
Bank Licences	159	184	198	213	222	
Mutual Funds	10,586	10,940	11,010	11,379	10,841	
Mutual Fund Administrators	106	108	115	121	124	
Registered Companies	96,248	98,838	99,459	95,530	93,612	
Captive insurance companies	740	739	788	788	768	

The tourism sector is the second main pillar of the Cayman Islands economy. The Cayman Islands tourism demographic is largely comprised of visitors from the United States of America ("US"). For 2016 78% of air arrivals to the country were citizens of the US. As such the US economy has a large impact on the economy of the Cayman Islands.

Both air and cruise arrivals for 2016 were comparable to 2015. Air arrivals have a direct impact on the Company's sales growth as these visitors are stay-over visitors who occupy the hotels. Cruise arrivals have an indirect impact as they affect the opening hours of the establishments operating for that market.

The following table presents statistics for tourist arrivals in the Cayman Islands for the year ending December 31:

Tourist Arrivals to the Cayman Islands						
(for the twelve months ending	December 31)					
	2016	2015	2014	2013	2012	
By Air	385,451	385,379	382,816	345,387	321,650	
By Sea	<u>1,711,849</u>	<u>1,716,812</u>	<u>1,609,555</u>	<u>1,375,872</u>	<u>1,507,370</u>	
Total	2,097,300	2,102,191	1,992,371	1,721,259	1,829,020	

The tourism industry is expected to be positively impacted by the expansion of the Owen Roberts International Airport in Grand Cayman. The expansion is expected to be completed in 2018 and will accommodate the anticipated growth in air arrivals. The expanded airport will provide a vastly improved airlift service for Grand Cayman's tourists. The new design expands the current facility and will feature a larger terminal which will accommodate the projected growth in air arrivals. In addition to the airport expansion, the tourism sector is expected to receive a boost by the completion of the Kimpton Seafire Resort and Residences. The luxury resort hotel was completed in November 2016, and hosts five restaurants and six beach front bungalows in addition to the 10 storey, 265 room ocean front complex. Both projects are expected to create additional employment opportunities and increase stay over tourism.



The Kimpton Seafire Resort and Residences was completed in November 2016.

All data is sourced from the Cayman Islands Government, Cayman Islands Economics & Statistics Office, Cayman Islands Monetary Authority and Cayman Islands Department of Tourism (www.gov.ky, www.eso.ky, www.cimonev.com.ky, www.caymanislands.ky)

#### **Liquidity and Capital Resources**

The primary sources of liquidity and capital resources are net funds generated from operations, debt markets, and bank credit facilities. These sources are used primarily to satisfy capital and intangible asset expenditures, service and repay debt, and pay dividends.

The following table outlines the summary of cash flow for Fiscal 2016 compared to Fiscal 2015:

Cash Flows				
(\$ thousands)				
	Year Ended	Year Ended	Change	% Change
	December 31,	December 31,		
	2016	2015		
Beginning cash	1,365	21,815	(20,450)	-94%
Cash provided by/(used in):				
Operating activities	61,739	59,021	2,718	5%
Investing activities	(47,560)	(78,574)	31,014	-39%
Financing activities	(5,683)	<u>(897)</u>	<u>(4,786)</u>	534%
Ending cash	9,861	1,365	8,496	622%

#### *Operating Activities:*

Cash flow provided by operations, after working capital adjustments, for Fiscal 2016, was \$61.7 million, an increase of \$2.7 million from \$59.0 million for Fiscal 2015. This increase was primarily due to increased earnings and changes in accounts payables and accrued expenses, partially offset by the changes in regulatory deferrals.

#### *Investing Activities:*

Cash used in investing activities for Fiscal 2016 totalled \$47.6 million, a decrease of \$31.0 million from \$78.6 for Fiscal 2015. This decrease is due to lower capital expenditures in Fiscal 2016, driven primarily by the completion of the generation expansion project.

## Financing Activities:

Cash used in financing activities totalled \$5.7 million for Fiscal 2016, an increase of \$4.8 million from \$0.9 of cash used in financing activities for Fiscal 2015. This decrease in cash provided by financing activities is attributable to the issuance of Class A Ordinary Shares under the 2015 Rights Offering, partially offset by 2016 proceeds from short term borrowings of \$30 million.

## *Cash Flow Requirements:*

The Company expects that operating expenses and interest costs will generally be paid from the Company's operating cash flows, with residual cash flows available for capital expenditures and dividend payments. Borrowings under credit facilities may be required from time to time to support seasonal working capital requirements. Cash flows required to complete planned capital expenditures are expected to be financed from a combination of proceeds from operating cash, debt and equity transactions. The Company expects to be able to source the cash required to fund its 2017 capital expenditure programme (see the "Business Risks" section of this MD&A for Liquidity Risk details).

#### **Credit Facilities**

The Company currently has \$50.0 million of unsecured credit financing facilities with the Scotiabank & Trust (Cayman) Limited ("Scotia") and Royal Bank of Canada ("RBC"). The financing facilities are comprised of:

Short-Term Financing	(\$ millions)
Provided by Scotia:	
Letters of Credit	\$1.0
Operating, Revolving Line of Credit	\$10.0
Catastrophe Standby Loan	\$7.5
Demand Loan Facility- Interim Funding of Capital Expenditures	<u>\$31.0</u>
Total	\$49.5
Provided by RBC:	
Corporate Credit Card Line	<u>\$0.5</u>
Total	\$0.5

Of the total above, \$19.0 million was available at December 31, 2016.

#### **Transactions with Related Parties**

Miscellaneous receivables from Newfoundland Power, a subsidiary of Fortis Inc., was \$10,526 at December 31, 2016 (nil as at December 31, 2015) for travel expenses. Miscellaneous payables to Fortis Inc., the Company's majority shareholder was \$4,485 at December 31, 2016 (\$3,300 as at December 31, 2015) for travel expenses, hurricane preparedness, membership fees and insurance premiums. The Company rents office facilities from a related party, Adare Investments Ltd., on a 5 year lease agreement ending June 30, 2019. Rent costs paid to Adare Investments Ltd. for Fiscal 2016 totaled \$91,596.

## **Contractual Obligations**

The contractual obligations of the Company over the next five years and periods thereafter, as at December 31, 2016, are outlined in the following table:

Contractual Obligations (\$ millions)					
Total debt	224.0	11.0	29.4	29.0	154.6
Long-term debt interest	88.2	11.0	19.4	15.7	42.1
Defined benefit pension	0.1	0.1	-	-	-
Total	312.3	22.1	48.8	44.7	196.7

## Power Purchase Obligation

During 2015, the Company entered into a Power Purchase Agreement ("PPA") with Entropy Cayman Solar Limited to purchase up to 2.1 MW per year of associated energy for a 25-year term. This 5 MW solar project is scheduled for completion by Second Quarter 2017 and will significantly reduce emissions into the atmosphere through the avoidance of diesel fuel consumption. The PPA will also provide renewable energy at a competitive initial price of \$0.17 cents per kWh. The PPA was approved by the ERA during the Fourth Quarter 2015. The PPA qualifies for the Normal Purchase Normal Sale exemption under ASC 815 and does not qualify as a derivative.

#### Fuel Purchase Obligation

The Company has a primary fuel supply contract with RUBiS Cayman Islands Limited ("RUBiS"). Under the agreement the Company is committed to purchase approximately 60% of its diesel fuel requirements for its generating plant from RUBiS. The Company also has a secondary fuel supply contract with Sol Petroleum Cayman Limited ("Sol") and is committed to purchase approximately 40% of the Company's fuel requirements for its generating plant from Sol. Contracts with RUBiS and Sol were executed in September 2012. Both contracts expired on July 31, 2014 with the option to renew for two additional 18 month terms. The Company executed 18 month fuel supply contracts in September 2014 upon the expiration of its previous fuel supply contract with both RUBiS and Sol. The Company renewed its contract with RUBiS on September 1, 2016 for the final term which expires on August 31, 2017. The approximate remaining quantities per the fuel contract on an annual basis are, by fiscal year in millions of IGs: 2017 – 13.4. The contract with Sol was renewed for the final term on March 1, 2016 which expires on August 31, 2017. The approximate remaining quantities per the fuel contract on an annual basis are, by fiscal year in millions of IGs: 2017 – 8.9. Both contracts qualify for the Normal Purchase Normal Sale exemption under ASC 815 and do not qualify as derivatives.

## **Financial Position**

The following table is a summary of significant changes to the Company's balance sheet from December 31, 2015 to December 31, 2016.

Significant changes in Balance Sheets				
(from December 31, 2015 to December 31, 2016)				
Balance Sheet Account	Increase/ (Decrease) (\$ millions)	Explanation		
Cash and Cash Equivalents	8.5	Increase due to cash provided by operating activities of \$61.7 million offset by cash used in financing activities of \$5.7 million and cash used in investing activities of \$47.6 million.		
Accounts Receivable	(1.4)	Lower billings due to a decrease in fuel costs.		
Bank Overdraft	(1.7)	Repayment of the Operating Line of Credit.		
Property, Plant and Equipment	19.5	Net increase is comprised of (1) capital expenditures of \$46.5 million (2) depreciation expense of \$29.3 million (3) \$2.3 million in accrued capital expenditure.		
Accounts Payable and Accrued Expenses	3.1	Increase attributable to increases in capital expenditure and operating expense accruals.		
Long-Term Debt	(10.8)	Decrease due to principal payments made on the Company's Senior Unsecured Notes.		
Share Premium	2.9	The Company issued 265,647 shares through its share purchase plans.		
Retained Earnings	2.3	Increase due to net earnings for the period of \$25.2 million offset by Class A dividends of \$21.9 million and Class B dividends of \$0.9 million.		

## **Capital Resources**

The Company's principal activity of generation, transmission and distribution of electricity in Grand Cayman requires CUC to have ongoing access to capital to build and maintain the electrical system for the community it serves.

To help ensure access to capital, the Company targets a long-term capital structure containing approximately 45% equity, including preference shares, and 55% debt. The Company's objective is to maintain investment-grade credit ratings. The Company sets the amount of capital in proportion to risk. The debt to equity ratio is managed through various methods such as the Class A Ordinary Share rights offering that occurred in 2015 and the Company's Share Purchase Plans.

Certain of the Company's long-term debt obligations have covenants restricting the issuance of additional debt such that consolidated debt cannot exceed 60% of the Company's consolidated capital structure, as defined by short-term and long-term debt agreements. As at December 31, 2016, the Company was in compliance with all debt covenants.

The Company's capital structure is presented in the following table:

Capital Structure							
	December 31, 2016 (\$ millions)	%	December 31, 2015 (\$ millions)	%			
Total debt	252.7	53	238.0	53			
Shareholder's equity	<u>220.0</u>	<u>47</u>	<u>214.4</u>	<u>47</u>			
Total	472.7	100	452.4	100			

The change in the Company's capital structure between December 31, 2016 and December 31, 2015 was driven by an increase in equity resulting from the issuance of Class A Ordinary Shares under its share purchase plans and an increase in Short-Term Debt.

The Company's credit ratings under Standard & Poors ("S&P") and the Dominion Bond Rating System ("DBRS") are as follows:

S&P A-/Stable DBRS A (low)

The S&P rating is in relation to long-term corporate credit and unsecured debt while the DBRS rating relates to senior unsecured debt.

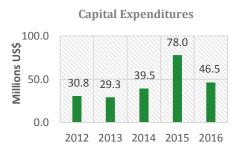
On the October 14, 2016 announcement from Fortis Inc. of the closing of the \$11.3 billion acquisition of ITC Holdings Corporation, a Michigan based Company that operates electricity transmission facilities in the United States, S&P affirmed the Company's A- rating and revised its outlook on the Company from negative to stable. The stable outlook on CUC reflects the closing of the transaction consistent with S&P's expectations including selling up to 19.9% of ITC to an infrastructure-focused minority investor. The A- rating reflects S&P's positive view of the Company's current position as the sole provider of generation services, and the Company's licenced position as the sole provider of T&D services. The rating also reflects S&P's positive view of regulatory support and stable cash flows offset by the economic uncertainty and the limited history of the regulator.

In March 2016, DBRS affirmed the Company's "A" credit rating while maintaining the categorisation of low with a Stable trend. Considerations for the rating were a supportive regulatory regime, solid credit metrics and a stable island economy and the demand for electricity. Impacting the rating were such factors as hurricane event risk and the small size of the Company's customer base.

## **Capital Expenditures**

Capital expenditures for Fiscal 2016 were \$46.5 million, a \$31.5 million, or 40% decrease from \$78.0 million in capital expenditures for the same period of the previous year. The capital expenditures for Fiscal 2016 primarily relate to:

- Distribution system extension and upgrades \$11.1 million.
- Generation Replacement Cost \$10.3 million
- 39.7 MW Generation Project \$18.5 million
- Facility and Auxiliary Asset Replacement Cost \$1.7 million
- Purchase of AMI meters and meter equipment \$4.7 million
- AFUDC of \$5.4 million was capitalized in Fiscal 2016



Capital expenditures					
(\$ thousands)					
	Year Ended December 31, 2016	Year Ended December 31, 2015	Change	% Change	Forecast 2017
Transmission	1.5	1.4	0.1	7%	15.2
Distribution	15.5	8.7	6.8	78%	15.4
Generation	27.1	66.1	(39.0)	-59%	18.7
Other	<u>2.4</u>	<u>1.8</u>	<u>0.6</u>	33%	<u>2.7</u>
Total	46.5	78.0	(31.5)	40%	52.0

## **Off Balance-Sheet Arrangements**

The Company has no off-balance sheet arrangements such as transactions, agreements or contractual arrangements with unconsolidated entities, structured finance entities, special purpose entities or variable interest entities that are reasonably likely to materially affect liquidity of or the availability of, or requirements for, capital resources.

#### **Business Risks**

The following is a summary of the Company's significant business risks:

## Operational Risks

Operational risks are those risks normally inherent in the operation of generating, transmission and distribution facilities. The Company's facilities are subject to the risk of equipment failure due to deterioration of the asset from use or age, latent defects and design or operator error, among other things. These risks could lead to longer-than-forecast equipment downtimes for maintenance and repair, disruptions of power generation, customer service interruptions, and could result in injury to employees and the public. Accordingly, to ensure the continued performance of the physical assets, the Company determines expenditures that must be made to maintain and replace the assets.

The Company continually develops capital expenditure, safety management and risk controls programmes and assesses current and future operating and maintenance expenses that will be incurred in the ongoing operation of its systems. The Company also has an insurance programme that provides coverage for business interruption, liability and property damage, although the coverage offered by this programme is limited (see the "Insurance" section for discussion of insurance terms and coverage). In the event of a large uninsurable loss, the Company would apply to the ERA for recovery of these costs through higher rates. However, there is no assurance that the ERA will approve any such application (see the "Regulation" section for discussion of regulatory risk).

#### **Economic Conditions**

The general economic condition of CUC's service area, Grand Cayman, influences electricity sales as with most utility companies. Changes in consumer income, employment and housing are all factors in the amount of sales generated. As the Company supplies electricity to all hotels and large properties, its sales are therefore partially based on tourism and related industry fluctuations.

## Regulation

The Company operates within a regulated environment. As such, the operations of the Company are subject to the normal uncertainties faced by regulated companies. Such uncertainties include approval by the ERA of billing rates that allow a reasonable opportunity to recover on a timely basis the estimated costs of providing services, including a fair return on rate base assets. The Company's capital expenditure plan requires regulatory approval. There is no assurance that capital projects perceived as required by the management of the Company will be approved by the ERA.

## Weather

CUC's facilities are subject to the effects of severe weather conditions principally during the hurricane season months of June through November. Despite preparations for disasters such as hurricanes, adverse conditions will always remain a risk. In order to mitigate some of this risk, the Company maintains insurance coverage which Management believes is appropriate and consistent with insurance policies obtained by similar companies.

#### **Environmental Matters**

CUC's operations are subject to local environmental protection laws concerning emissions to the air, discharges to surface and subsurface waters, noise, land use activities, and the handling, storage, processing, use, and disposal of materials and waste products.

CUC's Environmental Management System ("EMS") is registered to the ISO 14001 Environmental Standard. The Company was initially registered in 2004, pursuant to an audit by a third party of the Company's EMS to ensure that the Company was meeting requirements put in place by the Government as well as self-imposed requirements. Under the ISO 14001 standard companies are required to establish, document, implement, maintain and continually improve their environmental performance with an aim of prevention of pollution. In order to maintain the Company's registration to this standard an external surveillance audit is conducted annually, and an external audit is conducted every three years for re-certification. Internal audits of the system must also be conducted on an annual basis. CUC has most recently conducted, and passed its recertification audit in March 2016.

In May 2002, the United Kingdom ("UK") ratified the Kyoto Protocol, which sets targets and timetables for the reduction of greenhouse gas (GHG) emissions, which was later extended to the Cayman Islands in March 2007. Under the Kyoto Protocol, the UK is legally bound to reduce its GHG emissions, but Cayman has no emissions reduction target. As an overseas territory, the Cayman Islands are required to give available national statistics on an annual basis to the UK which will be added to its inventory and reported to the United Nations Framework Convention on Climate Change (UNFCCC) Secretariat. Under the Convention governments are obligated to gather and report information on GHG emissions through the preparation of a national greenhouse gas inventory. The inventory primarily requires the Cayman Islands to quantify as best as possible the country's fuel consumption across a variety of sectors, production processes and distribution means. CUC continues to supply the Department of Environment with data for Cayman's GHG inventory.

Through the EMS, CUC has determined that its exposure to environmental risks is not significant and does not have an impact on CUC's financial reporting including the recording of any Asset Retirement Obligations ("ARO's").

#### Insurance - Terms and Coverage

The Company renewed its insurance policy as at July 1, 2016 for one year under similar terms and coverage as in prior years. Insurance terms and coverage include \$100.0 million in property and machinery breakdown insurance and business interruption insurance per annum with a 24-month indemnity period and a waiting period on Non-Named Wind, Quake and Flood of 60-days. Any named Wind, Quake and Flood deductible has a 45-day waiting period. All T&D assets outside of 1,000 feet from the boundaries of the main power plant and substations are excluded, as the cost of such coverage is not considered economical. There is a single event cap of \$100 million. Each "loss occurrence" is subject to a deductible of \$1.0 million, except for windstorm (including hurricane) and earth movement for which the deductible is 2% of the value of each location that suffers loss, but subject to a minimum deductible of \$1.0 million and maximum deductible of \$4.0 million for all interests combined.

In accordance with the T&D Licence, when an asset is impaired or disposed of within its original estimated useful life, the cost of the asset is reduced and the net book value is charged to accumulated depreciation. This treatment is in accordance with rate regulated accounting and differs from the GAAP treatment of a loss being recognised on the statement of earnings. The amount charged to accumulated depreciation is net of any proceeds received in conjunction with the disposal of the asset. Insurance proceeds are included within the criteria.

In addition to the coverage discussed above, the Company has also purchased an excess layer of an additional \$100.0 million limit on property and business interruption (excluding windstorm, earth movement and flood).

The Company's insurance policy includes business interruption which covers losses resulting from the necessary interruption of business caused by direct physical loss or damage to CUC's covered property and loss of revenues resulting from damage to customers' property.

## Defined Benefit Pension Plan

The Company maintains a defined benefit pension plan, which provides a specified monthly benefit on retirement irrespective of individual investment returns. The assumed long-term rate of return on pension plan assets for the purposes of estimating pension expense for 2016 is 5%. This compares to assumed long-term rates of return of 5% used during 2015. There is no assurance that the pension plan assets will be able to earn the assumed rate of returns. The loss on pension plan assets during 2016 was 1% (2015: loss of 2%).

Market driven changes impacting the performance of the pension plan assets may result in material variations in actual return on pension plan assets from the assumed return on the assets causing material changes in consolidated pension expense and funding requirements. Net pension expense is impacted by, among other things, the amortization of experience and actuarial gains or losses and expected return on plan assets. Market driven changes impacting other pension assumptions, including the assumed discount rate, may also result in future consolidated contributions to pension plans that differ significantly from current estimates as well as causing material changes in consolidated pension expense. The discount rate assumed for 2016 is 4.0% compared to the discount rate assumed during 2015 of 4.0%.

There is also measurement uncertainty associated with pension expense, future funding requirements, the accrued benefit asset, accrued benefit liability and benefit obligation due to measurement uncertainty inherent in the actuarial valuation process.

A discussion of the critical accounting estimates associated with pensions is provided in the "Critical Accounting Estimates" section of this MD&A.

#### Financial Instruments

The Company is primarily exposed to credit risk, liquidity risk and interest rate risk as a result of holding financial instruments in the normal course of business. Financial instruments of the Company consist mainly of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, consumers' deposits and advances for construction and long-term debt.

#### Credit Risk

The Company is exposed to credit risk in the event of non-performance by counterparties to derivative financial instruments which include fuel option contracts. If a counterparty fails to perform on its contractual obligation to deliver payment when the market price of fuel is greater than the strike price, the Company may find it necessary to purchase diesel at the market price, which will be higher than the contract price. The Company manages this credit risk associated with counterparties by conducting business with high credit-quality institutions. The Company does not expect any counterparties to fail to meet their obligations.

There is risk that the Company may not be able to collect all of its accounts receivable and other assets. This does not represent a significant concentration of risk. The requirements for security deposits for certain customers, which are advance cash collections from customers to guarantee payment of electricity billings, reduces the exposure to credit risk. The Company manages credit risk primarily by executing its credit collection policy, including the requirement for security deposits, through the resources of its customer service department.

#### Liquidity Risk

The Company's financial position could be adversely affected if it failed to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange such financing is subject to numerous factors, including the results of operations and financial position of the Company, conditions in the capital and bank credit markets, ratings assigned by ratings agencies and general economic conditions. These factors are mitigated by the legal requirement under the Licences, which requires rates be set to enable the Company to achieve and maintain a sound credit rating in the financial markets of the world. The Company has also secured committed credit facilities to support short-term financing of capital expenditures and seasonal working capital requirements. The cost of renewed and extended credit facilities could increase in the future; however, any increase in interest expense and fees is not expected to materially impact the Company's consolidated financial results in 2017.

## Interest Rate Risk

Long-term debt is issued at fixed interest rates, thereby minimizing cash flow and interest rate exposure. The Company is primarily exposed to risks associated with fluctuating interest rates on its short-term borrowings and other variable interest credit facilities. The current amount of short-term borrowings is \$30 million (nil as at December 31, 2015).

#### **New Accounting Policies**

Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

Effective January 1, 2016, the Company adopted ASU No. 2014-15, which provides guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and provide related disclosures. The adoption of this update did not impact the Company's consolidated financial statements and related disclosures.

Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items

Effective January 1, 2016, the Company prospectively adopted ASU No. 2015-01, which is part of the Financial Accounting Standards Board's ("FASB's") initiative to reduce complexity in accounting standards by eliminating the concept of extraordinary items. The adoption of this update did not impact the Company's consolidated financial statements.

# Amendments to the Consolidation Analysis

Effective January 1, 2016, the Company adopted ASU No. 2015-02, which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. Specifically, the amendments note the following regarding limited partnerships: (i) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities; and (ii) eliminate the presumption that a general partner should consolidate a limited partnership. The amendments in this update did not materially impact the Company's consolidated financial statements.

## **Future Accounting Policies**

# Revenue from Contracts with Customers

ASU No. 2014-09 was issued in May 2014 and the amendments in this update create Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers, and supersede the revenue recognition requirements in ASC Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance throughout the codification. This standard clarifies the principles for recognizing revenue and can be applied consistently across various transactions, industries and capital markets. In 2016 a number of additional ASUs were issued that clarify implementation guidance in ASC Topic 606. This standard, and all related ASUs, is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted for annual and interim periods beginning after December 15, 2016. The Company and its subsidiary, DataLink Ltd., do not expect to early adopt.

The new guidance permits two methods of adoption: (i) the full retrospective method, under which comparative periods would be restated, and the cumulative impact of applying the standard would be recognized as at January 1, 2017, the earliest period presented; and (ii) the modified retrospective method, under which comparative periods would not be restated and the cumulative impact of applying the standard would be recognized at the date of initial adoption, January 1, 2018. The Company expects to use the modified retrospective approach, however, it continues to monitor industry developments. Any significant industry developments could change the Company's expected method of adoption.

The majority of the Company's revenue is generated from energy sales to retail customers based on published tariff rates, as approved by the respective regulators, and is considered to be in the scope of ASU No. 2014-09. The Company does not expect that the adoption of this standard, and all related ASUs, will have a material impact on the recognition of revenue generated from energy sales to retail customers, or on its remaining material revenue streams; however, continues to closely monitor industry developments related to the new standard. Certain industry specific interpretative issues, including contributions in aid of construction, remain outstanding and the conclusions reached, if different than currently anticipated, could have a material impact on the Company's consolidated financial statements and related disclosures. The Company continues to closely monitor industry developments related to the new standard.

#### Recognition and Measurement of Financial Assets and Financial Liabilities

ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, was issued in January 2016 and the amendments in this update address certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Most notably, the amendments require the following: (i) equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) to be measured at fair value through earnings; however, entities will be able to elect to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus subsequent adjustments for observable price changes; and (ii) financial assets and financial liabilities to be presented separately in the notes to the consolidated financial statements, grouped by measurement category and form of financial asset. This update is effective for annual and interim periods beginning after December 15, 2017. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

#### Leases

ASU No. 2016-02 was issued in February 2016 and the amendments in this update create ASC Topic 842, Leases, and supersede lease requirements in ASC Topic 840, Leases. The main provision of ASC Topic 842 is the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases that were previously classified as operating leases. For operating leases, a lessee is required to do the following: (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; (ii) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and (iii) classify all cash payments within operating activities in the statement of cash flows. These amendments also require qualitative disclosures along with specific quantitative disclosures. This update is effective for annual and interim periods beginning after December 15, 2018 and is to be applied using a modified retrospective approach with practical expedient options. Early adoption is permitted. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

#### Measurement of Credit Losses on Financial Instruments

ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, was issued in June 2016 and the amendments in this update require entities to use an expected credit loss methodology and to consider a broader range of reasonable and supportable information to inform credit loss estimates. This update is effective for annual and interim periods beginning after December 15, 2019 and is to be applied on a modified retrospective basis. Early adoption is permitted for annual and interim periods beginning after December 15, 2018. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

# Simplifying the Test for Goodwill Impairment

ASU No. 2017-04, Simplifying the Test for Goodwill Impairment, was issued in January 2017 and the amendments in this update simplify the subsequent measurement of goodwill by eliminating step two in the current two-step goodwill impairment test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. This update is effective for annual and interim periods beginning after December 15, 2019 and is to be applied on a prospective basis. Early adoption is permitted for interim and annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company expects to early adopt this update in 2017; however does not expect that it will have a material impact on its consolidated financial statements and related disclosures.

#### **Changes in Accounting Policies**

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period

Effective January 1, 2015, the Company early adopted ASU No. 2014-12 that resolves diversity in practice for employee share-based payments with performance targets that can entitle an employee to benefit from an award regardless of if they are rendering services at the date the performance target is achieved. The adoption of this update did not have an impact on the Company's consolidated financial statements.

#### Simplifying the Presentation of Debt Issuance Costs

Effective December 1, 2015, the Company early adopted ASU No. 2015-03 that requires debt issuance costs to be presented on the consolidated balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The adoption of this update was applied retrospectively and resulted in the reclassification of debt issuance costs of \$1.6 million from Other Assets to Long-Term Debt on the Company's consolidated Balance Sheet as at December 31, 2014. Additionally, the Company early adopted ASU No. 2015-15 that clarifies the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. The update permits an entity to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The adoption of this update was applied retrospectively and did not have a material impact on the Company's consolidated financial statements.

# **Critical Accounting Estimates**

The preparation of the Company's financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Estimates are based on historical experience, current conditions and various other assumptions believed to be reasonable under the circumstances. Due to changes in facts and circumstances and the inherent uncertainty involved in making estimates, actual results may differ significantly from the current estimates. Estimates are reviewed periodically and, as adjustments become necessary, are reported in earnings in the period in which they become known. The Company's critical accounting estimates relate to:

#### Revenue Recognition

Revenue derived from the sale of electricity is taken to income on a bills-rendered basis, adjusted for unbilled revenues. Customer bills are issued throughout the month based on meter readings that establish electricity consumption since the last meter reading. The unbilled revenue accrual for the period is based on estimated electricity sales to customers since the last meter reading. The estimation process for accrued unbilled electricity consumption will result in adjustments of electricity revenue in the periods they become known when actual results differ from the estimates. As at December 31, 2016, the amount of unbilled revenue recorded in Electricity Sales was \$2.2 million (December 31, 2015: \$2.2 million).

# Kilowatt-Hour ("kWh") Sales

Kilowatt-hour sales throughout the month are based on meter readings that establish electricity consumption since the last meter reading. The kWh accrual for the period is based on estimated electricity sales to customers since the last meter reading. The estimation process for electricity consumption will result in adjustments of kWh sales statistics in the periods they become known when actual results differ from the estimates. As at December 31, 2016, the amount of estimated kWh sales was 23.9 million kWh (December 31, 2015: 16.6 million kWh).

#### **Employee Future Benefits**

The Company's defined benefit pension plan is subject to judgments utilised in the actuarial determination of the expense and related obligation. There are currently two participants in the Company's defined benefit pension plan. The main assumptions utilized by Management in determining pension expense and obligations were the discount rate for the accrued benefit obligation, pension commencement date, inflation and the expected rate of return on plan assets. As at December 31, 2016, the Company has a long term liability of \$1.0 million (December 31, 2015: \$1.2 million).

# Property, Plant and Equipment Depreciation

Depreciation is an estimate based primarily on the estimated useful life of the asset. Estimated useful lives are based on current facts and historical information and take into consideration the anticipated physical life of the assets. As at December 31, 2016, the net book value of the Company's PP&E was \$467.2 million compared to \$447.7 million as at December 31, 2015, increasing as a result of the Company's generation and T&D capital expenditures. Depreciation expense for Fiscal 2016 was \$29.3 million (\$26.0 million for the Fiscal 2015). Due to the value of the Company's property, plant and equipment, changes in depreciation rates can have a significant impact on the Company's depreciation expense.

### **Selected Annual Financial Information**

The "Selected Annual Financial Information" table shows the Annual Financial Information for the financial years ended December 31, 2016, 2015 and 2014.

#### **Selected Annual Financial Information**

(expressed in \$ thousands except Basic Earnings per Class A Ordinary Share, Dividends declared per Class A Ordinary Share and where otherwise indicated

	Year ended December 31, 2016	Year ended December 31, 2015	Year ended December 31, 2014
Operating Revenues	161,702	188,880	231,705
Net Earnings	25,211	22,842	20,815
Net Earnings Applicable to common shares	24,266	21,912	19,885
Total Assets	509,861	482,806	463,830
Debt	211,746	222,594	236,436
Preference shares	250	250	250
Total shareholder's equity	220,122	214,489	179,835
Earnings per Class A Ordinary Share	0.75	0.71	0.68
Diluted earnings per Class A Ordinary Share	0.75	0.71	0.68
Dividends declared per Class A Ordinary Share	0.675	0.66	0.66
Dividends declared per Class B Preference Share including bonus	3.78	3.72	3.72

#### Comparative results 2016/2015

Operating revenues for Fiscal 2016 totalled \$161.7 million, a decrease of \$27.2 million from \$188.9 million for Fiscal 2015.

Net earnings for the year ended December 31, 2016 ("Fiscal 2016") were \$25.2 million, a \$2.4 million increase from net earnings of \$22.8 million for the year ended December 31, 2015 ("Fiscal 2015"). This increase is attributable to a 4% increase in kWh sales, 0.9% and 0.1% base rate increases effective June 1, 2015 and June 1, 2016 respectively, lower, finance charges and increased other income. These items were partially offset by higher depreciation, maintenance and general and administration costs. For a discussion of the reasons for the changes in Operating Revenues, Net Earnings Applicable to common shares and Earnings per Class A Ordinary Share, refer to the "Operating Revenues" and "Earnings" sections of this MD&A.

The growth in total assets is due mainly to the construction of a new 39.7MW power plant, which was commissioned in June 2016. The decrease in long-term debt was due to debt repayments of \$14 million in Fiscal 2016.

# Comparative Results 2015/2014

Operating revenues for Fiscal 2015 totalled \$188.9 million, a decrease of \$42.8 million from \$231.7 million for Fiscal 2014.

Net earnings for the year ended December 31, 2015 ("Fiscal 2015") were 22.8 million, a \$2.0 million increase from net earnings of \$20.8 million for the year ended December 31, 2014 ("Fiscal 2014"). This increase was attributable to a 3% increase in kWh sales, 1.5% and 0.9% base rate increases effective June 1, 2014 and June 1, 2015 respectively, lower finance charges and increased other income. These items were partially offset by higher depreciation, maintenance and general and administration costs.

The growth in total assets was due mainly to the construction of a new 39.7 MW power plant, which was commissioned in June 2016. The decrease in long-term debt was due to debt repayments of \$14 million in Fiscal 2015.

#### 2016 Fourth Quarter Results

Net earnings for the three months ended December 31, 2016 ("Fourth Quarter 2016") were \$5.4 million, a \$0.8 million decrease when compared to \$6.2 million for the three months ended December 31, 2015 ("Fourth Quarter 2015"). This decrease is due to higher depreciation and finance costs for the Fourth Quarter 2016 when compared to the Fourth Quarter 2015. These items were partially offset by a 2% increase in kWh sales and lower consumer service expenses.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Fourth Quarter 2016 were \$4.7 million, or \$0.15 per Class A Ordinary Share, as compared to \$5.6 million, or \$0.18 per Class A Ordinary Share for the Fourth Quarter 2015.

Kilowatt-hour sales for the Fourth Quarter 2016 were 149.6 million, an increase of 3.1 million kWh when compared to 146.5 million for the Fourth Quarter 2015. Sales were positively impacted by drier weather conditions.

Total operating expenses for the Fourth Quarter 2016 decreased 12% or \$5.0 million to \$35.0 million from \$40.0 million for the Fourth Quarter 2015. The main contributing factors to the decrease in operating expenses were lower power generation expenses, which were comprised predominantly of fuel costs, and lower consumer service expenses. These factors were partially offset by higher depreciation costs.

Cash flow provided by operations, after working capital adjustments, for the Fourth Quarter 2016, was \$15.8 million, an increase of \$0.4 million when compared to \$15.4 million for the Fourth Quarter 2015. This increase was primarily due to increased earnings and changes in non-cash working capital balances. Cash used in investing activities totalled \$9.3 million for the Fourth Quarter 2016, a decrease of \$15.9 million from \$25.2 million for the Fourth Quarter 2015. This decrease is due to lower capital expenditures. Cash used in financing activities totalled \$8.1 million for the Fourth Quarter 2016, an increase of \$1.8 million from \$6.3 million used in financing activities for the Fourth Quarter 2015. The increase relates to the repayment of the bank overdraft.

Capital expenditures for the Fourth Quarter 2016 were \$9.8 million, a \$15.2 million, or 61%, decrease from \$25.0 million in capital expenditures for the Fourth Quarter 2015.

Quarterly Results

The table "Quarterly Results" summarises unaudited quarterly information for each of the eight quarters ended March 31, 2015 through December 31, 2016. This information has been obtained from CUC's unaudited interim Financial Statements, which in the opinion of Management have been prepared in accordance with US GAAP. These operating results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

Quarterly results					
(\$ thousands, except basic a	ınd diluted earnings p	er ordinary share)			
	Operating Revenue	Net Earnings	Income applicable to Class A Ordinary shares	Earnings per Class A Ordinary share	Diluted earnings per Class A Ordinary share
December 31, 2016	41,181	5,368	4,760	0.15	0.15
September 30, 2016	42,873	7,371	7,258	0.22	0.22
June 30, 2016	37,915	7,544	7,431	0.23	0.23
March 31, 2016	39,732	4,975	4,862	0.15	0.15
December 31, 2015	45,882	6,151	5,558	0.18	0.18
September 30, 2015	50,242	7,893	7,780	0.25	0.25
June 30, 2015	44,048	5,514	5,401	0.17	0.17
March 31, 2015	48,709	3,284	3,171	0.11	0.11

#### December 2016/December 2015

Net earnings for the three months ended December 31, 2016 ("Fourth Quarter 2016") were \$5.4 million, a \$0.8 million decrease when compared to \$6.2 million for the three months ended December 31, 2015 ("Fourth Quarter 2015"). This decrease is attributable higher depreciation and finance charges. These items were partially offset by lower consumer service costs for the Fourth Quarter 2016 when compared to the Fourth Quarter 2015.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Fourth Quarter 2016 were \$4.7 million, or \$0.15 per Class A Ordinary Share, as compared to \$5.6 million, or \$0.18 per Class A Ordinary Share for the Fourth Quarter 2015

#### September 2016/September 2015

Net earnings for the three months ended September 30, 2016 ("Third Quarter 2016") totalled \$7.4 million, a decrease of \$0.5 million when compared to net earnings of \$7.9 million for the three months ended September 30, 2015 ("Third Quarter 2015"). This decrease was due mainly to higher depreciation and finance charges. The higher depreciation and finance charges were as anticipated by the Company and were driven by the completion of the 39.7 megawatts ("MW") Generation Project in June 2016. These items were partially offset by higher electricity sales revenues.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Third Quarter 2016 were \$7.3 million, or \$0.22 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$7.8 million or \$0.25 per Class A Ordinary Share for the Third Quarter 2015.

# June 2016/June 2015

Operating income for Second Quarter 2016 totalled \$7.2 million, an increase of \$0.8 million when compared to operating income of \$6.4 million for Second Quarter 2015. The increase was primarily attributable to the 7% increase in kWh sales partially offset by higher depreciation and general and administration costs.

In addition to the factors positively impacting operating income, net earnings increased as a result of higher capitalization of interest expenses through the Allowance for Funds Used During Construction ("AFUDC") of \$1.7 million in Second Quarter 2016 when compared to \$1.0 million in Second Quarter 2015. The increase in AFUDC, and resulting reduction in Finance Charges, was due primarily to the Company's 39.7 MW Generation Project which was completed in June 2016. AFUDC is the capitalisation of Financing Cost which is calculated by multiplying the Company's Cost of Capital rate by the average construction work in progress for each month.

The Company anticipated a reduction in AFUDC and an increase in depreciation costs commencing with the completion of the Generation Project.

Net earnings for the three months ended June 30, 2016 totalled \$7.5 million, an increase of \$2.0 million when compared to net earnings of \$5.5 million for the three months ended June 30, 2015 ("Second Quarter 2015").

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Second Quarter 2016 were \$7.4 million, or \$0.23 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$5.4 million or \$0.17 per Class A Ordinary Share for Second Quarter 2015.

# *March 2016/March 2015*

Operating income for First Quarter 2016 totalled \$5.1 million, an increase of \$0.6 million when compared to operating income of \$4.5 million for First Quarter 2015. The increase was attributable to the 5% increase in kWh sales and lower general and administration costs. These items were partially offset by higher depreciation, maintenance and amortization costs.

In addition to the factors positively impacting operating income, net earnings increased as a result of higher capitalization of interest expenses through the Allowance for Funds Used During Construction ("AFUDC") of \$1.9 million in First Quarter 2016 when compared to \$0.9 million in First Quarter 2015. The increase in AFUDC, and resulting reduction in Finance Charges, was due primarily to the Company's ongoing 39.7 MW Generation Project. AFUDC is the capitalisation of Financing Cost which is calculated by multiplying the Company's Cost of Capital rate by the average work in progress for each month.

Net Earnings for the First Quarter 2016 totalled \$5.0 million, an increase of \$1.7 million when compared to net earnings of \$3.3 million for the First Quarter 2015.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the First Quarter 2016 were \$4.9 million, or \$0.15 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$3.2 million or \$0.11 per Class A Ordinary Share for the First Quarter 2015.

#### **Disclosure Controls and Procedures**

The President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), together with Management, have established and maintained the Company's disclosure controls and procedures (DC&P), to provide reasonable assurance that material information relating to the Company is made known to them by others, particularly during the year ending December 31, 2016; and information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation. Based on the evaluation performed over disclosure controls and procedures, it was concluded that the DC&P of CUC is adequately designed and operating effectively as of December 31, 2016.

# Internal Controls over Financial Reporting ("ICFR")

The CEO and CFO of the Company, together with Management, have established and maintained the Company's internal control over financial reporting (ICFR), as defined in National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with US GAAP.

The design of CUC's internal controls over financial reporting has been established and evaluated using the criteria set forth in the Internal Control-Integrated Framework by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the assessment, it was concluded that CUC's internal controls over financial reporting are adequately designed and operating effectively as of December 31, 2016.

There has been no change in the Company's ICFR that occurred during the period beginning on October 1, 2016 and ended on December 31, 2016 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

#### Outlook

In December 2016 the ERA approved CUC's 2017-2021 Capital Investment Plan in the amount of \$219 million. Approved projects for the upcoming period include completion of ongoing generation and T&D system replacements and upgrades.

The Company launched the Integrated Resource Plan ("IRP") study in 2016. The study analyses all energy resources that are viable and considers their cost, reliability, environmental impact and other aspects and provides a recommended portfolio of energy resources for the market. The Company's goal is to ensure that all energy options are explored before decisions are made on what the grid can accommodate in a safe, reliable and efficient manner. The IRP will give shape to the energy generation plans for Grand Cayman over the next 30 years.

A committee to establish a National Energy Policy ("NEP") was appointed by the Government in 2010. The goal of the policy is to ensure security, reliability and affordability of energy supplies in the Cayman Islands, as well as to reduce the Islands' carbon footprint and diversify power sources. A draft NEP was issued for discussion in 2013 but was not legislated. In January 2016, the Government appointed a new NEP Review Committee which includes CUC representation. It is the intention of the Cayman Islands Government to implement the National Energy Policy into legislation in 2017.

Effective 16 January 2017 as a consequence of the commencement of the Utility Regulation and Competition Office, Law 2016, along with other sector specific laws, the Electricity Regulatory Authority ("ERA"), the Information & Communication Technology Authority ("ICTA") and the Cayman Petroleum Inspectorate merged into one entity - OfReg. This merger did not impact the terms and conditions of the T&D Licence, the Generation Licence, nor the DataLink License.

# **Subsequent Events: Outstanding Share Data**

At February 13, 2017 the Company had issued and outstanding 32,647,278 Ordinary Shares and 250,000 9% cumulative Participating Class B Preference Shares.

The number of common shares of the Company that would be issued if all outstanding stock options were converted as at February 13, 2017 is as follows.

Conversion of Securities into Common Shares	Number of
As at February 13, 2017 (Unaudited)	Common Shares
Stock Options	282,720

Additional information, including CUC's Annual Information Form, is available on SEDAR at www.sedar.com and on the Company's website at www.cuc-cayman.com.

# Management's Responsibility for Financial Reporting

The accompanying Annual Consolidated Financial Statements of Caribbean Utilities Company, Ltd. and all information in the 2016 Annual Report have been prepared by management, who are responsible for the integrity of the information presented, including the amounts that must of necessity be based on estimates and informed judgements. These Annual Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States. Financial information contained elsewhere in the 2016 Annual Report is consistent with that in the Annual Consolidated Financial Statements.

In meeting its responsibility for the reliability and integrity of the Annual Consolidated Financial Statements, management has developed and maintains a system of accounting and reporting which provides for the necessary internal controls to ensure transactions are properly authorised and recorded, assets are safeguarded and liabilities are recognised. The Company focuses on the need for training of qualified and professional staff, effective communication between management and staff and management guidelines and policies.

The Board of Directors oversees management's responsibilities for financial reporting through an Audit Committee that is composed entirely of outside directors. The Audit Committee meets with the external auditors, with and without management present, to discuss the results of the audit, the adequacy of the internal accounting controls and the quality and integrity of financial reporting. The Audit Committee reviews the Company's Annual Consolidated Financial Statements before the statements are recommended to the Board of Directors for approval. The external auditors have full and free access to the Audit Committee.

The Audit Committee has the duty to review the adoption of, and changes in, accounting principles and practices which have a material effect on the Annual Consolidated Financial Statements, to review financial reports requiring Board approval prior to submission to securities commissions or other regulatory authorities, to assess and review management's judgments material to reported financial information and to review the external auditors' fees.

The Annual Consolidated Financial Statements and Management's Discussion and Analysis contained in the 2016 Annual Report were reviewed by the Audit Committee and, on their recommendation, were approved by the Board of Directors of the Company. Ernst & Young, Ltd., independent auditors appointed by the shareholders of the Company upon recommendation of the Audit Committee, have performed an audit of the Annual Consolidated Financial Statements and their report follows.

Letitia T. Lawrence

Vice President Finance & Chief Financial Officer

Caribbean Utilities Company, Ltd.

J.F. Richard Hew

President & Chief Executive Officer

half Samuel !

Caribbean Utilities Company, Ltd.

# Auditors' Report

# To the Shareholders of Caribbean Utilities Company, Ltd.

We have audited the accompanying consolidated financial statements of Caribbean Utilities Company, Ltd., which comprise the consolidated balance sheets as at December 31, 2016 and 2015, and the consolidated statements of earnings, comprehensive income, shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

# Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

# Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

#### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Caribbean Utilities Company, Ltd. as at December 31, 2016 and 2015 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States.

Ernst & Young, Ltd.

Grand Cayman, Cayman Islands

Ernst + Young Ltd.

February 13, 2017

# **Consolidated Balance Sheets**

(expressed in thousands of United States Dollars)

	Note	As at December 31, 2016	As at December 31, 2015
Assets		01,2010	01,2010
Current Assets			
Cash and Cash Equivalents		9,861	1,365
Accounts Receivable	5	10,366	11,767
Related Party Receivables	20	17	, -
Regulatory Assets	6	13,605	14,346
Inventories	7	3,136	2,237
Prepayments		2,599	2,096
		39,584	31,811
Property, Plant and Equipment	8	467,214	447,700
Other Assets		24	24
Intangible Assets	9	3,039	3,271
Total Assets		509,861	482,806
Liabilities and Shareholders' Equity		551,552	
Current Liabilities			
Bank Overdraft		-	1,735
Accounts Payable and Accrued Expenses	10	23,471	20,410
Related Party Payables	20	4	14
Regulatory Liabilities	6	1,625	863
Short-Term Debt	16	30,000	-
Current Portion of Long-Term Debt		11,000	14,000
Consumers' Deposits and Advances for Construction		10,231	6,823
*		76,331	43,845
Defined Benefit Pension Liability		1,036	1,242
Long-Term Debt	11	211,746	222,594
Other Long term Liabilities	13	626	636
Total Liabilities		289,739	268,317
Shareholders' Equity			
Share Capital		2,193	2,177
Share Premium		119,096	116,201
Additional Paid in Capital	13	467	467
Retained Earnings		99,156	96,822
Accumulated Other Comprehensive Loss		(790)	(1,178)
Total Shareholders' Equity		220,122	214,489
Total Liabilities and Shareholders' Equity		509,861	482,806

See accompanying Notes to Annual Consolidated Financial Statements

Agreed on behalf of the Board of Directors by:

David E. Ritch, OBE, JP

Director

J.F. Richard Hew

Tomm

Director

# **Consolidated Statements of Earnings**

(expressed in thousands of United States Dollars, except basic and diluted earnings per ordinary share and the Weighted Average of Class A Ordinary Shares issued and fully paid)

	Note	Year Ended	Year Ended
		December 31,	December 31,
		2016	2015
Operating Revenues			
Electricity Sales		80,183	76,747
Fuel Factor		81,519	112,133
Total Operating Revenues		161,702	188,880
Operating Expenses			
Power Generation		85,271	116,105
General and Administration		8,691	9,134
Consumer Services		2,318	3,212
Transmission and Distribution		2,904	2,853
Depreciation		29,257	25,961
Maintenance		5,736	5,861
Amortization of Intangible Assets		625	487
Total Operating Expenses		134,802	163,613
Operating Income		26,900	25,267
Other (Expenses)/Income:			
Finance Charges	17	(6,768)	(7,301)
Foreign Exchange Gain	19	1,158	1,435
Other Income		3,921	3,441
Total Net Other (Expenses)/Income		(1,689)	(2,425)
Earnings for the Period		25,211	22,842
Preference Dividends Paid- Class B		(945)	(930)
Earnings on Class A Ordinary Shares		24,266	21,912
Weighted-Average Number of Class A Ordinary Shares Issued and Fu	ıllv		
Paid (in thousands)	14	32,483	31,041
Earnings per Class A Ordinary Share	14	0.75	0.71
Diluted Earnings per Class A Ordinary Share	14	0.75	0.71
Dividends Declared per Class A Ordinary Share		0.675	0.660

# Consolidated Statements of Comprehensive Income

(expressed in thousands of United States Dollars)

	Year Ended December 31, 2016	Year Ended December 31, 2015
Earnings for the Period	25,211	22,842
Other Comprehensive Income:		
Amounts arising during the period		
Defined Benefit Pension plans:		
Net actuarial gain	165	2
Reclassification to net income		
Defined Benefit Pension plans:		
Amortization of net actuarial loss	223	206
Total Other Comprehensive Income	388	208
Comprehensive Income	25,599	23,050

# Consolidated Statements of Shareholders' Equity (expressed in thousands of United States Dollars except Common Shares)

	Class A Ordinary Shares (in thousands)	Class A Ordinary Shares Value (\$)	Preference Shares (\$)	Share Premium (\$)	Additional Paid-in Capital (\$)	Accumulated Other Comprehensive Loss (\$)	Retained Earnings (\$)	Total Equity (\$)
As at January 1, 2016	32,382	1,927	250	116,201	467	(1,178)	96,822	214,489
Net earnings	-	-	-	-	-	-	25,211	25,211
Common share issuance and stock options plans	265	16	-	2,895	-	-	-	2,911
Defined benefit plans	-	-	-	-	-	388	-	388
Dividends on common shares	-	-	-	-	-	-	(21,932)	(21,932)
Dividends on preference shares	-	-	-	-	-	-	(945)	(945)
As at December 31, 2016	32,647	1,943	250	119,096	467	(790)	99,156	220,122
As at January 1, 2015	29,260	1,742	250	83,044	463	(1,386)	95,722	179,835
Net earnings	-	-	-	-	-	-	22,842	22,842
Common share issuance and stock options plans	3,122	185	-	33,157	4	-	-	33,346
Defined benefit plans	-	-	-	-	-	208	-	208
Dividends on common shares	-	-	-	-	-	-	(20,812)	(20,812)
Dividends on preference shares	-	-	-	-	-	-	(930)	(930)
As at December 31, 2015	32,382	1,927	250	116,201	467	(1,178)	96,822	214,489

# Consolidated Statements of Cash Flows

(expressed in thousands of United States Dollars)

	Year Ended December 31, 2016	Year Ended December 31, 2015
Operating Activities		, , ,
Earnings for the period	25,211	22,842
Items not affecting cash:		
Depreciation	29,257	25,961
Amortization of Intangible Assets	625	487
Non-cash Pension Expenses	(3)	48
Amortization of Deferred Financing Costs	146	161
Stock-based compensation	1	4
	55,237	49,503
Accounts Receivable	1,401	2,505
Inventory	(899)	1,280
Prepaid Expenses	(503)	697
Accounts Payable	3,061	(6,890)
Net Change in Regulatory Deferrals	1,504	9,915
Other	1,938	2,011
Cash flow related to operating activities	61,739	59,021
Investing Activities		
Purchase of property, plant and equipment	(47,207)	(77,947)
Costs related to intangible assets	(353)	(627)
Cash flow related to investing activities	(47,560)	(78,574)
Financing Activities		
Short-term borrowings	30,000	-
Repayment of debt	(14,000)	(14,000)
(Decrease)/Increase in bank overdraft	(1,735)	1,735
Dividends paid	(22,863)	(21,976)
Net proceeds from share issues	2,915	33,344
Cash flow related to financing activities	(5,683)	(897)
Increase/(Decrease) in net cash and cash equivalents	8,496	(20,450)
Cash and cash equivalents - Beginning of period	1,365	(20,450)
Cash and cash equivalents - End of period	9,861	1,365
Supplemental disclosure of cash flow information:		
Interest paid during the period	12,081	12,529

# Notes to Annual Consolidated Financial Statements

(expressed in thousands of United States dollars unless otherwise stated)

# 1. Nature of Operations and Consolidated Financial Statement Presentation

These consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles ("US GAAP") and reflect the decisions of the Electricity Regulatory Authority ("ERA"). The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary DataLink, Ltd ("DataLink"). These decisions affect the timing of the recognition of certain transactions resulting in the recognition of regulatory assets and liabilities, which Caribbean Utilities Company, Ltd., ("CUC" or the "Company") considers it is probable to recover or settle subsequently through the rate-setting process.

The principal activity of the Company is to generate and distribute electricity in its licence area of Grand Cayman, Cayman Islands, pursuant to a 20-year exclusive Transmission & Distribution ("T&D") Licence and a 25 year non-exclusive Generation Licence (collectively the "Licences") with the Cayman Islands Government (the "Government"), which expire in April 2028 and November 2039 respectively.

In March 2012 CUC's wholly-owned subsidiary, DataLink, received its licence from the Information and Communications Technology Authority ("ICTA") which permits DataLink to provide fibre optic infrastructure and other information and communication technology ("ICT") services to the ICT industry.

The ICTA is an independent statutory Authority which was created by the enactment of the Information and Communications Technology Authority Law on May 17, 2002 and is responsible for the regulation and licensing of Telecommunications, Broadcasting, and all forms of radio. The ICTA sets the standards by which ICT networks must be developed and operated under.

All significant intercompany balances and transactions have been eliminated on consolidation.

#### **Rate Regulated Operations**

CUC's base rates are designed to recover all non-fuel and non-regulatory costs and include per kilowatt-hour ("kWh") electricity charges and fixed facilities charges. Fuel cost charges and regulatory fees are billed as separate line items. Base rates are subject to an annual review and adjustment each June through the Rate Cap and Adjustment Mechanism ("RCAM"). In June 2016, following review and approval by the Electricity Regulatory Authority ("ERA"), the Company increased its base rates by 0.1%. This increase was a result of the 2015 Return on Rate Base ("RORB") and the increase in the applicable United States ("US") and Cayman Islands consumer price indices, adjusted to exclude food and fuel, for calendar year 2015. The change in the base rates as a percentage of the US and Cayman Islands consumer price indices was 80% based on the range of the RORB values. The required rate adjustment of 0.1% can be calculated by applying 80% to the total price level index (60% of the Cayman Islands CPI and 40% of the US CPI) of 0.12%. All fuel and lubricating oil costs are passed through to customers without mark-up as a per kWh charge.

For regulatory purposes fixed assets comprise the completed Property, Plant and Equipment ("PP&E") and intangible assets acquired or constructed by the Company as reported in the Company's consolidated financial statements. The original book value of these fixed assets include an Allowance for Funds Used During Construction ("AFUDC")(Note 8) and an allowance for General Expenses Capitalised ("GEC")(Note 8). GEC is calculated as a percentage of up to 10% of Non-Fuel Operating Expenses, varying annually depending on the level of capital activity.

# 2. <u>Summary of Significant Accounting Policies</u>

The preparation of financial statements in conformity with US GAAP requires Management 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's critical accounting estimates relate to:

# Revenue Recognition

Revenue from the sale of electricity is recognised on an accrual basis. Electricity is metered upon delivery to customers and recognised as revenue when consumed using rates that are approved by the ERA. Billing rates are generally bundled to include service associated with generation, transmission and distribution. Meters are read periodically and bills are issued to customers based on these readings. At the end of each period, a certain amount of consumed electricity will not have been billed. Electricity consumed but not yet billed to customers is estimated and accrued as unbilled revenue at each period end.

Transmission is the conveyance of electricity at high voltages (generally at 69 kilovolts ("kV") and higher). Distribution networks convey electricity from transmission systems to end-use customers.

CUC passes through 100% of fuel costs to consumers on a two-month lag basis. This is recorded as Fuel Factor Revenues.

#### **Consolidation Policy**

The consolidated financial statements include the accounts of the Company, and its wholly owned subsidiary, DataLink. All significant intercompany balances and transactions have been eliminated in consolidation.

#### Kilowatt-Hour (kWh) Sales

Kilowatt-hour sales throughout the month are based on meter readings that establish electricity consumption since the last meter reading. The kWh accrual for the period is based on estimated electricity sales to customers since the last meter reading.

#### Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand, bank demand deposits and bank fixed deposits maturing within three months of the date of acquisition. At December 31, 2016, cash and cash equivalents consisted of all cash.

## Accounts Receivable

Accounts receivable are included in the balance sheet net of the allowance for doubtful accounts and are due within 21 days of billing. Insurance receivables are recorded when recovery becomes reasonably assured.

#### Allowance for Doubtful Accounts

The Company maintains an accumulated provision for uncollectible customer accounts receivable that is estimated based on known accounts, historical experience and other currently available information, including the economic environment. Accounts receivable is written-off in the period in which the receivable is deemed uncollectible; only inactive customers qualify for write-off. Inactive customers are customers who no longer have electricity service. Customers with past-due accounts are eligible for a short-term payment program ("STPP"), in order to ensure that electricity service is not made inactive due to non-payment of past due amounts.

#### **Inventories**

Fuel and lube oil are carried at cost. Line inventory is carried at cost less provision for obsolescence. Inventories are consumed/utilized on an average cost basis. Inventories are valued at lower of cost and market.

# Property, Plant and Equipment (PP&E)

PP&E are stated at cost.

The cost of additions to PP&E is the original cost of contracted services, direct labour and related overheads, materials, GEC and AFUDC. Line inventory that is foreseeable as capitalisable is included in PP&E less provision for obsolescence. Major spare parts and stand-by equipment to be used during more than one period qualify as PP&E. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of PP&E, they are accounted for as PP&E. Damaged PP&E are written off, or appropriate provision made, where damage relates to assets that will be reconstructed.

The Company capitalizes GEC, which represents certain overhead costs not directly attributable to specific PP&E but which do relate to the overall capital expenditure programme. Additionally, the Company capitalizes an AFUDC, which represents the cost of debt and equity financing incurred during construction of PP&E.

Contributions in aid of construction represent amounts contributed by customers and governments for the cost of utility capital assets. These contributions are recorded as a reduction in the cost of utility capital assets and are being amortized annually by an amount equal to the charge for depreciation on the related assets.

Upon disposition of PP&E the original cost will be removed from the capital asset accounts, that amount net of salvage proceeds, will also be removed from accumulated depreciation, as such, any resulting gain or loss will be charged to accumulated depreciation.

Depreciation is provided on the cost of PP&E (except for freehold land, capitalized projects in progress, line inventory and spare parts) on a straight-line basis over the estimated useful lives of the assets as follows:

	Years
Transmission and distribution	20 to 50
Generation	20 to 50
Other: Buildings	20 to 50
Motor Vehicles	5 to 15
Equipment and computers	3 to 20

#### Property, Plant and Equipment Depreciation

Depreciation, by its very nature is an estimate based primarily on the estimated useful life of the asset. Estimated useful lives are based on current facts and historical information and take into consideration the anticipated physical life of the assets.

#### Intangible Assets

Intangible assets include deferred licence renewal costs, computer software, and trademark expenses. Intangible assets, excluding trademark expenses and assets in progress are being amortized on a straightline basis over the life of the asset. Deferred licence renewal costs are being amortized over a range of 15 years to 20 years on a straight-line basis. Computer software costs are being amortized over a range of three to 10 years on a straight-line basis.

#### Foreign Exchange

Monetary assets and liabilities denominated in foreign currencies are translated into United States Dollars at the exchange rate prevailing on the Balance Sheet date. Revenue and expense items denominated in foreign currencies are translated into United States Dollars at the exchange rate prevailing on the transaction date. Gains and losses on translation are included in the Statement of Earnings.

The Company translates its Cayman Islands Dollars to United States Dollars at a fixed rate of CI\$0.84 to US\$1.00.

#### Other Income

Other income is comprised of pole rental fees, income from pipeline operations, sale of meter sockets, sale of recyclable metals and other miscellaneous income.

Other Income is recognised when sales are delivered, services are rendered and rental fees are recognised over the period of the lease.

# Segment Information

The Company operates in one business segment, electricity generation, transmission and distribution, in one geographic area, Grand Cayman, Cayman Islands.

#### Fair Values

The fair value of financial assets and liabilities has been determined from market values where available. Where fair values of financial instruments with an immediate or short-term maturity are considered to approximate cost, this fact is disclosed. Fair value of financial assets and liabilities for which no market value is readily available is determined by the Company using future cash flows discounted at an estimated market rate. In establishing an estimated market rate, the Company has evaluated the existing transactions, as well as comparable industry and economic data and other relevant factors such as pending transactions.

#### Capital Stock

#### Dividend Reinvestment Plan

All dividends payable on Class A Ordinary Shares recorded for participation in the Plan, including Class A Ordinary Shares acquired and retained under the Plan, will be used by CUC to purchase additional Class A Ordinary Shares at the prevailing market price for the Participant's account on the Investment Date.

#### Customer Share Purchase Plan ("CSPP")

The CSPP provides an opportunity for customers resident in Grand Cayman to invest in CUC. Customers may make cash payments of not less than \$30 per purchase and up to a total of \$14,000 per year for the purchase of Class A Ordinary Shares of CUC; and retain the Class A Ordinary Shares in the Plan and have the cash dividends on such shares reinvested in additional Class A Ordinary Shares. In both instances, the Class A Ordinary Shares are acquired from CUC at not more than 100% of the average market price which is calculated using the daily closing prices of CUC Class A Ordinary Shares on the Toronto Stock Exchange over a specified period.

#### Employee Share Purchase Plan (ESPP")

The Company provides interest-free advances to employees to purchase Class A Ordinary Shares, with such advances recovered through payroll deductions over the next year. The maximum semi-annual participation is 1,000 Class A Ordinary Shares per employee. The plan is non-compensatory as shares purchased by the employee are obtained at the prevailing market value at the time of purchase. The amount owing to the

Company from employees is included as an offset to Share Capital and Share Premium on the Balance Sheets (2016: \$0.16 million, 2015: \$0.12 million).

## Share Based Compensation Plans

The Company has a policy of measuring compensation expense upon the issuance of stock options. Using the fair value method, the compensation expense is amortised over the four-year vesting period of the options. Upon exercise, the proceeds of the option are credited to Share Capital at CI\$0.05 and the difference from the exercise price to Share Premium. Therefore an exercise of options below the current market price has a dilutive effect on capital stock and Shareholders' Equity.

The Company also records the liabilities associated with its Performance Share Unit ("PSU") Plans at their fair value at each reporting date until settlement, recognizing compensation expense over the vesting period. The fair value of the PSU liability is based on the Company's common share closing price at the end of each reporting period relative to the S&P/TSX Utilities Index over a three year period. The fair value of the PSU liability is also based on expected payout based on historical performance in accordance with defined metrics of each grant, where applicable, and management's best estimate.

# **Employee Benefit Plans**

The Company maintains defined contribution pension plans for its employees and defined benefit pension plan for the retired Chairman of the Company's Board of Directors as well as the retired President and Chief Executive Officer. The pension costs of the defined contribution plan are recorded as incurred.

The pension costs of the defined benefit plan are actuarially determined using the projected benefits method prorated on service and best estimate assumptions. Past service costs from plan initiation are amortised on a straight-line basis over the remaining service period of the employee active at the date of initiation. The excess of any cumulative net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets at the beginning of the year, are deferred and amortised over the remaining service period of the employee. The balance of any such actuarial gain (loss) is recognised in Accumulated Other Comprehensive Income. The Company's defined benefit pension plan is subject to judgments utilised in the actuarial determination of the expense and related obligation.

#### Financial Instruments

Financial instruments are contracts that give rise to a financial asset of one party and a financial liability or equity instrument of another party. The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, short-term borrowings, consumer deposits, other long-term liabilities and long term debt. All financial instruments are initially measured at fair value.

Subsequent adjustment of held-to-maturity instruments are taken to the Statement of Earnings, whereas changes in fair value for available-for-sale instruments are recorded in other comprehensive income. Debt securities classified as held-to-maturity are recorded at amortized cost.

The Company's policy is to defer transaction costs associated with financial assets and liabilities. These transaction costs are amortized into earnings using the effective interest rate method over the life of the related financial instrument, outstanding balances are recognised as a reduction to long term debt on the balance sheet.

#### **Derivatives**

The Company uses derivatives to reduce the impact of volatility in the Fuel Cost Charge paid by the Company's customers for the fuel that the Company must purchase in order to provide electricity service. The program utilises call options to promote transparency in pricing. The programme utilises call options creating a ceiling price for fuel costs at pre-determined contract premiums.

The derivatives entered into by the Company relate to regulated operations and all contracts are recognised as either regulatory assets or liabilities and are measured at fair value. Any resulting gains or losses and changes to fair value are recorded in the regulatory asset/regulatory liability accounts, subject to regulatory approval. Cash inflows and outflows associated with the settlement of all derivative instruments are included in operating cash flows on the Company's statements of cash flows.

## 3. <u>Future Accounting Policies</u>

Revenue from Contracts with Customers

ASU No. 2014-09 was issued in May 2014 and the amendments in this update create Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers, and supersede the revenue recognition requirements in ASC Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance throughout the codification. This standard clarifies the principles for recognizing revenue and can be applied consistently across various transactions, industries and capital markets. In 2016 a number of additional ASUs were issued that clarify implementation guidance in ASC Topic 606. This standard, and all related ASUs, is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted for annual and interim periods beginning after December 15, 2016. The Company and its subsidiary, DataLink Ltd., do not expect to early adopt.

The new guidance permits two methods of adoption: (i) the full retrospective method, under which comparative periods would be restated, and the cumulative impact of applying the standard would be recognized as at January 1, 2017, the earliest period presented; and (ii) the modified retrospective method, under which comparative periods would not be restated and the cumulative impact of applying the standard would be recognized at the date of initial adoption, January 1, 2018. The Company expects to use the modified retrospective approach, however, it continues to monitor industry developments. Any significant industry developments could change the Company's expected method of adoption.

The majority of the Company's revenue is generated from energy sales to retail customers based on published tariff rates, as approved by the respective regulators, and is considered to be in the scope of ASU No. 2014-09. The Company does not expect that the adoption of this standard, and all related ASUs, will have a material impact on the recognition of revenue generated from energy sales to retail customers, or on its remaining material revenue streams; however, continues to closely monitor industry developments related to the new standard. Certain industry specific interpretative issues, including contributions in aid of construction, remain outstanding and the conclusions reached, if different than currently anticipated, could have a material impact on the Company's consolidated financial statements and related disclosures. The Company continues to closely monitor industry developments related to the new standard.

Recognition and Measurement of Financial Assets and Financial Liabilities

ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, was issued in January 2016 and the amendments in this update address certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Most notably, the amendments require the following:

(i) equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) to be measured at fair value through earnings; however, entities will be able to elect to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus subsequent adjustments for observable price changes; and (ii) financial assets and financial liabilities to be presented separately in the notes to the consolidated financial statements, grouped by measurement category and form of financial asset. This update is effective for annual and interim periods beginning after December 15, 2017. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

#### Leases

ASU No. 2016-02 was issued in February 2016 and the amendments in this update create ASC Topic 842, Leases, and supersede lease requirements in ASC Topic 840, Leases. The main provision of ASC Topic 842 is the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases that were previously classified as operating leases. For operating leases, a lessee is required to do the following: (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; (ii) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and (iii) classify all cash payments within operating activities in the statement of cash flows. These amendments also require qualitative disclosures along with specific quantitative disclosures. This update is effective for annual and interim periods beginning after December 15, 2018 and is to be applied using a modified retrospective approach with practical expedient options. Early adoption is permitted. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

## Measurement of Credit Losses on Financial Instruments

ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, was issued in June 2016 and the amendments in this update require entities to use an expected credit loss methodology and to consider a broader range of reasonable and supportable information to inform credit loss estimates. This update is effective for annual and interim periods beginning after December 15, 2019 and is to be applied on a modified retrospective basis. Early adoption is permitted for annual and interim periods beginning after December 15, 2018. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

#### Simplifying the Test for Goodwill Impairment

ASU No. 2017-04, Simplifying the Test for Goodwill Impairment, was issued in January 2017 and the amendments in this update simplify the subsequent measurement of goodwill by eliminating step two in the current two-step goodwill impairment test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. This update is effective for annual and interim periods beginning after December 15, 2019 and is to be applied on a prospective basis. Early adoption is permitted for interim and annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company expects to early adopt this update in 2017; however does not expect that it will have a material impact on its consolidated financial statements and related disclosures.

## 4. Changes in Accounting Policies

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period

Effective January 1, 2015, the Company early adopted ASU No. 2014-12 that resolves diversity in practice for employee share-based payments with performance targets that can entitle an employee to benefit from an award regardless of if they are rendering services at the date the performance target is achieved. The adoption of this update did not have an impact on the Company's consolidated financial statements.

# Simplifying the Presentation of Debt Issuance Costs

Effective December 1, 2015, the Company early adopted ASU No. 2015-03 that requires debt issuance costs to be presented on the consolidated balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The Company early adopted ASU No. 2015-15 that clarifies the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. The update permits an entity to defer and present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The adoption of this update was applied retrospectively and did not have a material impact on the Company's consolidated financial statements.

#### 5. Accounts Receivable

Accounts Receivable		
(\$ thousands)		
	As at December 31, 2016	As at December 31, 2015
Billings to consumers*	8,915	10,593
Unbilled revenues	2,241	2,160
Other receivables	1,197	1,232
Allowance for doubtful accounts	(1,987)	(2,218)
Total accounts receivable	10,366	11,767

<sup>\*</sup>Includes billings to Datalink customers

#### **Unbilled Revenues**

Revenue derived from the sale of electricity is taken to income on a bills-rendered basis, adjusted for unbilled revenues. Customer bills are issued at the beginning of each month based on meter readings that establish electricity consumption since the last meter reading. The unbilled revenue accrual for the period is based on estimated electricity sales to customers since the last meter reading. The estimation process for accrued unbilled electricity consumption will result in adjustments of electricity revenue in the periods they become known when actual results differ from the estimates. Consumers are billed at the beginning of each month leading to the accrual of approximately three weeks of unbilled revenue.

#### Other Receivables

Other receivables relate to amounts due outside of the normal course of operations. Items in other accounts receivable include sale of inventory and machine break-down costs covered by warranties.

# 6. Regulatory Assets and Liabilities

Regulatory Assets and Liabilit	ies		
(\$ thousands)			
		As at December 31,	As at December 31,
Asset/Liability	Description	2016	2015
Regulatory Assets	Fuel Tracker Account (a)	13,244	13,866
Regulatory Assets	Derivative contract (b)	116	208
	Miscellaneous Regulatory		
Regulatory Assets	Assets (c)	<u>245</u>	<u>272</u>
Total Regulatory Assets		13,605	14,346
	Government & Regulatory		
Regulatory Liabilities	Tracker Account (d)	(1,625)	(812)
	Miscellaneous Regulatory		
Regulatory Liabilities	Liabilities (e)	1	<u>(51)</u>
Total Regulatory Liabilities		(1,625)	(863)

- a) Fuel Tracker Account The T&D Licence established a fuel tracker mechanism to ensure the Company and the consumers neither gain nor lose from the pass through of fuel costs. The purpose of the fuel tracker account is to accumulate actual fuel costs incurred less fuel factor revenues collected. This account represents deferred accumulated fuel costs to be recovered from or reimbursed to the consumers. The receivable or payable value represents a regulatory asset or liability. The net position of the fuel tracker accounts fluctuates monthly and is affected by fuel prices and electricity consumption.
- b) Derivative contract The Company's purpose of hedging is to reduce the impact of volatility in the Fuel Cost Charge paid by the Company's customers in the face of price volatility for the fuel that the Company must purchase in order to provide electric service. This account represents the fair value adjustments for the call options.
- c) Miscellaneous regulatory assets represent costs incurred by the Company, other than fuel and the specifically itemised licence and regulatory fees, to be recovered through the Company's base rates on terms as agreed with the ERA.
- d) Government and Regulatory Tracker Account A licence fee of 1% of gross revenues applies to customer billings for consumption over 1,000 kWh per month as a pass-through charge on a per kWh basis. Additionally, a regulatory fee of ½ of 1% is charged on gross revenues then prorated and applied only to customer billings with consumption over 1,000 kWh per month. The government and regulatory tracker account is the actual fee incurred less the amount of funds received from consumers. The per kWh charge is then adjusted quarterly for the balance of this account.
- e) Miscellaneous regulatory liabilities represent costs owed by the Company, other than licence and regulatory fees, to be recovered through the Company's base rates on terms as agreed with the ERA.

# 7. Inventories

The composition of inventories is shown in the table below:

Inventories		
(\$ thousands)		
	As at December 31, 2016	As at December 31, 2015
Fuel	2,289	1,392
Lubricating Oil	524	547
Line spares	104	76
DataLink, Ltd.	211	211
Other	<u>8</u>	11
Total	3,136	2,237

# 8. Property, Plant and Equipment (PP&E)

Property, Plant and Equipment			
(\$ thousands)			
	Cost	Accumulated Depreciation	Net Book Value December 31, 2016
Transmission & Distribution (T&D)	322,512	121,149	201,363
Generation	413,515	169,159	244,356
Other:			
Land	5,304	-	5,304
Buildings	20,167	11,549	8,618
Equipment, motor vehicles and computers	25,158	18,044	7,114
Total of T&D, Generation and Other	786,656	319,901	466,755
Datalink, Ltd.	541	82	459
Property, plant and equipment	787,197	319,983	467,214
	Cost	Accumulated Depreciation	Net Book Value December 31, 2015
Transmission & Distribution (T&D)	310,299	111,750	198,549
Transmission & Distribution (T&D) Generation	310,299 379,354	111,750 151,065	198,549 228,289
	•	•	•
Generation	•	•	,
Generation Other:	379,354	•	228,289
Generation Other: Land	379,354 5,304	151,065	228,289 5,304
Generation Other: Land Buildings	379,354 5,304 20,167	151,065 - 11,081	228,289 5,304 9,086
Generation Other:  Land Buildings Equipment, motor vehicles and computers	379,354 5,304 20,167 22,676	151,065 - 11,081 16,692	228,289 5,304 9,086 5,985

Included in PP&E are a number of capital projects in progress with a total cost to date of \$35.9 million (December 31, 2015: \$83.1 million). These projects primarily relate to various improvements to the Distribution System. The total cost incurred to date for the 39.7 MW Generation project is \$47.9 million. Included in the total cost is an amount of \$0.06 million that relates to fibre optic assets for DataLink.

Also included in Generation and T&D is freehold land with a cost of \$5.0 million (December 31, 2015: \$5.0 million). In addition, line inventory with a cost of \$3.3 million (December 31, 2015: \$4.3 million) is included in T&D. Engine spares with a net book value of \$13.8 million (December 31, 2015: \$13.7 million) are included in Generation.

The capitalisation of 'Financing Costs' is calculated by multiplying the Company's Cost of Capital rate by the average work in progress for each month. The cost of capital rate for fiscal 2016 is 7.75% (2015: 8.25%) and will be adjusted annually. As a result, during Fiscal 2016, the Company recognised \$ 5.4 million in AFUDC (2015: \$5.3 million). GEC of \$4.3 million was recognised for the year ended December 31, 2016 (2016: \$4.2 million).

In accordance with the Licences, when an asset is impaired or disposed of, before the original estimated useful life, the cost of the asset is reduced and the net book value is charged to accumulated depreciation. This treatment is in accordance with the rate regulations standard under US GAAP and differs from non-regulatory treatment of a loss being recognised on the statement of earnings. The amount charged to accumulated depreciation is net of any proceeds received in conjunction with the disposal of the asset. This amount within accumulated depreciation is to be depreciated as per the remaining life of the asset based on the original life when the unit was initially placed into service.

# 9. <u>Intangible Assets</u>

Intangible Assets			
(\$ thousands)			
	Cost	Accumulated	Net Book Value
		Amortisation	<b>December 31, 2016</b>
Deferred licence renewal costs	1,890	821	1,069
DataLink, Ltd. deferred licence renewal costs	200	63	137
Computer Software	6,594	4,963	1,631
Other Intangible Assets in progress	127	-	127
Trademark Costs	<u>75</u>	Ξ.	<u>75</u>
Total	8,886	5,847	3,039
	Cost	Accumulated	Net Book Value
		Amortisation	<b>December 31, 2015</b>
Deferred licence renewal costs	1,890	725	1,165
DataLink, Ltd. deferred licence renewal costs	200	50	150
Computer Software	6,200	4,446	1,754
Other Intangible Assets in progress	127	=	127
Trademark Costs	<u>75</u>	=	<u>75</u>
Total	8,492	5,221	3,271

Deferred licence renewal costs relate to negotiations with the Government for licences for the Company. Amortization of deferred licence renewal costs commenced upon conclusion of licence negotiations in April 2008 and extends over the life of the licences. Amortization of Datalink deferred licence renewal costs commenced upon conclusion of licence negotiations in March 2012 and extends over the life of the licence.

The expected amortization of intangible assets for the next five years is as follows:

Amortization of Intangible Assets					
(\$ Thousands)					
	2017	2018	2019	2020	2021
Computer Software	302	456	523	587	394
Licence Renewal Costs	<u>108</u>	<u>108</u>	<u>108</u>	<u>108</u>	<u>108</u>
Total	410	564	631	695	502

The weighted-average amortization period for intangible assets is as follows:

	As at December 31, 2016
Computer Software	3.39 years
Deferred Licence Renewal costs	11.29 years
Datalink Deferred Licence Renewal Costs	11.25 years
Total weighted-average amortization period	6.27 years

# 10. Accounts Payable and Accrued Expenses

Accounts Payable and Accrued Expenses		
(\$ thousands)		
	As at December 31, 2016	As at December 31, 2015
Fuel Cost Payable	13,175	13,556
Trade Accounts Payable & Accrued expenses	5,323	3,252
Accrued Interest	934	991
Dividends Payable	607	592
Other Accounts Payable	<u>3,432</u>	<u>2,019</u>
Total Accounts Payable	23,471	20,410

Included in Other Accounts Payable is an amount related to fuel option contracts (see Note 15) of \$0.1 million at December 31, 2016 (\$0.2 million at December 31, 2015).

# 11. Long-Term Debt

Long-Term Debt		
(\$ thousands)		
	As At December 31, 2016	As At December 31, 2015
6.67% Senior Unsecured Loan Notes due 2016	-	3,000
5.09% Senior Unsecured Loan Notes due 2018	8,000	12,000
5.96% Senior Unsecured Loan Notes due 2020	12,000	15,000
5.65% Senior Unsecured Loan Notes due 2022	24,000	28,000
7.50% Senior Unsecured Loan Notes due 2024	40,000	40,000
4.85% Senior Unsecured Loan Notes due 2026	15,000	15,000
3.34% Senior Unsecured Loan Notes due 2028	10,000	10,000
3.65% Senior Unsecured Loan Notes due 2029	30,000	30,000
5.10% Senior Unsecured Loan Notes due 2031	25,000	25,000
3.54% Senior Unsecured Loan Notes due 2033	40,000	40,000
3.85% Senior Unsecured Loan Notes due 2034	5,000	5,000
4.53% Senior Unsecured Loan Notes due 2046	<u>15,000</u>	<u>15,000</u>
	224,000	238,000
Less: Current portion of long-term debt	(11,000)	(14,000)
Less: Deferred debt issue costs	<u>(1,254)</u>	(1,406)
	211,746	222,594

Long-term debt repayments per fiscal year are as follows:

Year	\$
2017	11,000
2018	16,714
2019	12,714
2020	14,857
2021	14,130
2022 and later	154.585

All long-term debt is denominated in United States dollars.

# 12. <u>Capital Stock</u>

The table below shows the number of authorised shares of the Company (shares as follows fully stated, not in thousands):

Capital Stock				
	As at December 31,	As at December 31,		
	2016	2015		
Class A Ordinary Shares of CI\$0.05 each	60,000,000	60,000,000		
9% Cumulative Participating Class B Preference Shares of \$1.00 each	250,000	250,000		
Class C Preference Shares of \$1.00	419,666	419,666		
Cumulative Participating Class D Share of CI\$0.56	1	1		

# 13. Share Based Compensation Plans

## **Share Options**

The shareholders of the Company approved an Executive Stock Option Plan ("ESOP') on October 24, 1991, under which certain employees and officers may be granted options to purchase Class A Ordinary Shares of the Company.

The exercise price per share in respect of options is equal to the fair market value of the Class A Ordinary Shares on the date of grant. Each option is for a term not exceeding ten years, and will become exercisable on a cumulative basis at the end of each year following the date of grant. The maximum number of Class A Ordinary Shares under option shall be fixed and approved by the shareholders of the Company from time to time and is currently set at 1,220,100. Options are forfeited if they are not exercised prior to their respective expiry date or upon termination of employment prior to the completion of the vesting period.

Subject to certain amendments requiring shareholder approval, the Board of Directors may amend or discontinue the ESOP at any time without shareholder approval subject to Toronto Stock Exchange ("TSX") regulations, provided, however, that any amendment that may materially and adversely affect any option rights previously granted to a participant under the Option Plan must be consented to in writing by the Participant.

Share Options				
	Year Ended December 31, 2016	Year Ended December 31, 2016		
	Number of options	Weighted average exercise price per share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (\$ millions))
Outstanding at beginning of period	282,720	10.53	-	-
Granted	-	-	-	-
Exercised	(83,970)	9.58	-	-
Forfeited/Cancelled	(5,250)	11.61	-	-
Expired	· · · · · · · · · · · · · · · · · · ·	0.00	_	_
Outstanding, end of period	<u>193,500</u>	10.92	2.99	=
Vested, end of the period	193,500	10.92	2.99	-

On March 9, 2012; 187,000 options were granted under the Executive Stock Option Plan at an exercise price of \$9.66. The options vest on the basis of one quarter of the grant on each of the first through fourth anniversaries of the dates of the grant and bear a term of 10 years from the date of grant, thereby expiring on March 9, 2022. The fair value of each option granted was calculated to be \$0.02 per option. The fair value was estimated on the date of the grant using the Black-Scholes fair value option pricing model and the following assumptions:

Dividend Yield (%):	7.00
Expected Volatility (%):	5.50
Risk-free interest rate (%):	2.00
Expected life (years):	7.00

**Share Options** 

Cancelled / Forfeited

0.02

0.02

The following table summarizes additional information related to the stock options during 2016 and 2015:

Share Options			
(\$ millions)			
	2016	2015	
Stock Options expense recognised	0.001	0.003	
Stock options exercised:			
Cash received for exercise of options	0.8	0.04	
Intrinsic value realized by employees	0.1921	0.004	

Under the fair value method, the compensation expense was \$0.001 million for the year ended December 31, 2016 (December 31, 2015: \$0.003 million), resulting in a corresponding increase of Additional Paid in Capital.

(\$ millions)		
	Number of options	Weighted-Average Grant Date Fair Value
Non-vested options, January 1, 2016	40,250	0.02
Granted	-	-
Vested	35,000	

The unrecognised compensation expense related to non-vested share options for the year ended December 31, 2016 was nil (December 31, 2015: \$0.001 million).

5,250

#### Performance Share Unit ("PSU") Plan

Non-vested options, December 31, 2016

In September 2013, the Board approved a PSU plan under which officers and certain employees would receive PSUs. Each PSU represents a unit with an underlying value which is based on the value of one common share relative to the S&P/TSX Utilities Index.

PSU's outstanding as at December 31, 2016 relate to grants in March 2014 in the amount of 22,000, March 2015 in the amount of 22,000 and March 2016 in the amount of 25,000. The vesting period of the grant is three years, at which time a cash payment may be made to plan participants after evaluation by the Board of Directors of the achievement of certain payment criteria.

For the year ended December 31, 2016, an expense of \$0.2 million (December 31, 2015: \$0.4 million) was recognised in earnings with respect to the PSU plan.

As at December 31, 2016, the total liability related to outstanding PSUs is \$ 0.6 million (December 31, 2015: \$0.6 million) and is included in Other Long Term Liabilities.

# 14. <u>Earnings per Share</u>

The Company calculates earnings per share on the weighted average number of Class A Ordinary Shares outstanding. The weighted average Class A Ordinary Shares outstanding were 32,483,387 and 31,041,240 for the year ended December 31, 2016 and December 31, 2015 respectively.

The weighted average of Class A Ordinary Shares used for determining diluted earnings were 32,520,205 and 31,059,215 for the year ended December 31, 2016 and December 31, 2015, respectively. Diluted earnings per Class A Ordinary Share was calculated using the treasury stock method.

As at December 31, 2016 the outstanding options are not materially dilutive as the market price of common shares is below or marginally higher than the exercise price.

Earnings per Share			
	Earnings December 31, 2016 (\$ thousands)	Weighted average shares December 31, 2016 (\$ thousands)	Earnings per Class A Ordinary Shares December 31, 2016
Net earnings applicable to common shares	24,266		
Weighted Average share outstanding		32,483	
Basic Earnings Per Common Share			0.75
Effect of potential dilutive securities:			
Stock Options	Ξ.	<u>18</u>	Ξ.
Diluted Earnings per Common Share	24,266	32,501	0.75

	Earnings December 31, 2015 (\$ thousands)	Weighted average shares December 31, 2015	Earnings per Class A Ordinary Shares December 31, 2015
Net earnings applicable to common shares	21,912		_
Weighted Average share outstanding		31,041	
Rights Offering			0.71
Basic Earnings Per Common Share			
Effect of potential dilutive securities: Stock Options	Ξ.	<u>18</u>	=
Diluted Earnings per Common Share	21.912	31.059	0.71

#### 15. Fair Value Measurement

Fair value is the price at which a market participant could sell an asset or transfer a liability to an unrelated party. A fair value measurement is required to reflect the assumptions that market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risks inherent in a particular valuation technique, such as a pricing model, and the risks inherent in the inputs to the model. A fair value hierarchy exists that prioritizes the inputs used to measure fair value. The Company is required to determine the fair value of all derivative instruments in accordance with the following hierarchy:

The three levels of the fair value hierarchy are defined as follows:

- Level 1: Fair value determined using unadjusted quoted prices in active markets.
- Level 2: Fair value determined using pricing inputs that are observable.
- Level 3: Fair value determined using unobservable inputs only when relevant observable inputs are not available.

The fair values of the Company's financial instruments, including derivatives, reflect a point-in-time estimate based on current and relevant market information about the instruments as at the balance sheet dates. The estimates cannot be determined with precision as they involve uncertainties and matters of judgment and, therefore, may not be relevant in predicting the Company's future earnings or cash flows.

The estimated fair values of the Company's financial instruments, including derivative financial instruments, are as follows:

Financial Instruments				
((\$ thousands)	As at December 31, 2016 Carrying		As at December 31, 2015	
	Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current				
portion	222,746	232,369	236,594	251,723
Fuel Option Contracts1	116	116	208	208

<sup>1</sup> Carrying value of fuel option contracts included in Accounts Payable and Accrued expenses

The fair value of long-term debt is determined by discounting the future cash flows of each debt instrument at an estimated yield to maturity equivalent to benchmark government bonds or treasury bills, with similar terms to maturity, plus a market credit risk premium equal to that of issuers of similar credit quality. Since the Company does not intend to settle the long-term debt prior to maturity, the fair value estimate does not represent an actual liability and, therefore, does not include exchange or settlement costs.

The Company measures the fair value of commodity contracts on a daily basis using the closing values observed on commodities exchanges and in over-the-counter markets, or through the use of industry-standard valuation techniques, such as option modelling or discounted cash flow methods, incorporating observable valuation inputs. The resulting measurements are the best estimate of fair value as represented by the transfer of the asset or liability through an orderly transaction in the marketplace at the measurement date.

The fair value of the fuel option contract reflects only the value of the heating oil derivative and not the offsetting change in the value of the underlying future purchases of heating oil. The derivatives' fair value shown in the below table reflects the estimated amount the Company would pay to terminate the contract at the stated date. The fair value has been determined using published market prices for heating oil commodities. The Company's current option contracts will expire by October 2017.

The derivatives entered into by the Company relate to regulated operations and any resulting gains or losses and changes to fair value are recorded in the regulatory asset/regulatory liability accounts, subject to regulatory approval and passed through to customers in future rates.

The following table summarizes the fair value measurements of the Company's long term debt and fuel derivative contracts based on the three levels that distinguish the level of pricing observability utilized in measuring fair value.

	December 31, 2016	December 31, 2016	December 31, 2016	December 31, 2016
		Level 1 - Quoted Prices in active markets for	Level 2 - Significant Other	Level 3 - Significant unobservable
Financial Liability	Total Fair Value	identical assets	inputs	inputs
Long-term debt, including current				
portion	232,369		232,369	
Option contracts <sup>1</sup>	116		116	

<sup>1</sup> Carrying value of fuel option contracts included in Accounts Payable and Accrued expenses

# 16. Financial Risk Management

The Company is primarily exposed to credit risk, liquidity risk and interest rate risk as a result of holding financial instruments in the normal course of business.

#### Credit Risk

The Company is exposed to credit risk in the event of non-performance by counterparties to derivative financial instruments which include fuel option contracts. If counterparty fails to perform on its contractual obligation to deliver payment when the market price of fuel is greater than the strike price, the Company may find it necessary to purchase diesel at the market price, which will be higher than the contract price. The Company manages this credit risk associated with counterparties by conducting business with high credit-quality institutions. The Company does not expect any counterparties to fail to meet their obligations.

There is risk that CUC may not be able to collect all of its accounts receivable and other assets. This does not represent a significant concentration of risk. The requirements for security deposits for certain customers, which are advance cash collections from customers to guarantee payment of electricity billings, reduces the exposure to credit risk. CUC manages credit risk primarily by executing its credit collection policy, including the requirement for security deposits, through the resources of its customer service department.

#### Liquidity Risk

The Company's financial position could be adversely affected if it failed to arrange sufficient and costeffective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange such financing is subject to numerous factors, including the results of operations and financial position of the Company, conditions in the capital and bank credit markets, ratings assigned by ratings agencies and general economic conditions.

These factors are mitigated by the legal requirement per the Licences which requires rates be set to enable the Company to achieve and maintain a sound credit rating in the financial markets of the world. To further mitigate liquidity risk, the Company has secured committed credit facilities to support short-term financing of capital expenditures and seasonal working capital requirements.

The Company has \$50 million of unsecured credit financing facilities with Scotiabank & Trust (Cayman) Limited ("Scotia") and Royal Bank of Canada ("RBC"). The total available was \$19.0 million at December 31, 2016 (\$44.3 million at December 31, 2015).

#### Interest Rate Risk

Long-term debt is issued at fixed interest rates, thereby minimising cash flow and interest rate exposure. The Company is primarily exposed to risks associated with fluctuating interest rates on its short-term borrowings and other variable interest credit facilities. The current amount of short-term borrowings is \$30 million (nil as at December 31, 2015).

Short-Term Financing			
(\$ thousands)			
Credit Facilities	Total Credit Financing Facilities December 31, 2016	Total Utilised December 31, 2016	Total Available December 31, 2016
Corporate Credit Card Line*	500	500	-
Letter of Credit	1,000	500	500
Operating, Revolving Line of Credit	10,000	-	10,000
Catastrophe Standby Loan	7,500	-	7,500
Demand Loan Facility- Interim Funding of Capital Expenditures	<u>31,000</u>	<u>30.000</u>	<u>1,000</u>
Total	50,000	31,000	19,000

<sup>\*.</sup> Included in Accounts payable and accrued expenses

#### 17. Finance Charges

The composition of finance charges were as follows:

Finance Charges		
(\$ thousands)		
	Year Ended December 31, 2016	Year Ended December 31, 2015
Interest costs - long-term debt	11,632	12,440
Other interest costs AFUDC *	538 (5,402)	189 <u>(5,328)</u>
Total	6,768	7,301

\*Refer to PP&E with regards to AFUDC (Note 8) methodology.

# 18. <u>Employee Future Benefits</u>

All employees of the Company are members of a defined contribution Pension Plan established for the exclusive benefit of employees of the Company and which complies with the provisions of the National Pensions Law. As a term of employment, the Company contributes 7.5% of wages or salary in respect of employees who have completed 15 years of continuous service and have attained the age of 55 years and 5% of wages or salary for all other employees. All contributions, income and expenses of the plan are accrued to, and deducted from, the members' accounts. The total expense recorded in respect of employer contributions to the plan for Fiscal 2016 amounted to \$1.04 million (December 31, 2015: \$0.98 million). The Pension Plan is administered by an independent Trustee.

During 2003, the Company established a defined benefit pension plan for a Director of the Company. In May 2005, the Company's Board of Directors approved the establishment of a defined benefit pension plan for the retired President and Chief Executive Officer. The pension cost of the defined benefit plan is actuarially determined using the projected benefits method. In April 2007, the Company established an independent trust and the defined benefit plans were amalgamated at that time. An independent actuary performs a valuation of the obligations under the defined benefit pension plans at least every three years. The latest actuarial valuation of the pension plans for funding purposes is as at December 31, 2016.

The Company's broad investment objectives are to achieve a high rate of total return with a prudent level of risk taking while maintaining a high level of liquidity and diversification to avoid large losses and preserve capital over the long term.

The Company's defined benefit pension plan fund has a strategic asset allocation that targets a mix of approximately 40-70% equity investments, 20-40% fixed income investments, and 25% cash/cash equivalent securities. The fund's investment strategy emphasizes traditional investments in global equity and fixed income markets, using a combination of different investment styles and vehicles. The pension fund's equity investments include publicly traded investment grade equities, convertible debentures and real estate corporations. The fixed income investments include bonds issued by the United States Treasury, investment grade bonds, investment grade corporate bonds, investment grade Eurobonds and investment grade preference shares which are publicly traded. These equity and debt security vehicles include closed end or open end mutual or pooled funds.

The Company's defined benefit pension plan asset allocation was as follows:

Plan assets by allocation (%)					
	<b>December 31, 2016</b>	<b>December 31, 2015</b>			
Equity Assets	39%	49%			
Fixed income investments	29%	32%			
Money Market funds	18%	18%			
Cash and Cash equivalents	<u>14%</u>	<u>1%</u>			
Total	100%	100%			

The assets of the fund are traded and priced on active markets such as the New York Stock Exchange, American Stock Exchange, NASDAQ etc. The fair values of assets are provided by external quotation services which are considered reliable, but due to the nature of the market data, the accuracy of such prices cannot be guaranteed. Securities listed on a US national stock exchange are priced as of the close of the statement period. Corporate bonds, municipal bonds and other fixed income securities are priced by a computerized pricing service. Mutual fund shares are priced at net asset value. The fair value measurements of the Company's defined benefit pension plan assets by fair value hierarchy level are as follows:

Asset Allocation				
(\$ thousands)				
December 31, 2016				
	Quoted Prices in Active Markets for Identical Assets or Liabilities	Significant Other Observable Inputs (Level	Significant Other Unobservable	
	(Level 1)	2)	Inputs (Level 3)	Total
Equity Assets	2,405	-	-	2,405
Fixed income investments		1,770	-	1,770
Money Market funds		1,072	-	1,072
Cash and Cash equivalents	<u>882</u>	=	<u>-</u>	<u>882</u>
Total	3,287	2,842	-	6,129
December 31, 2015				
	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total
Equity Assets	2,984	-	-	2,984
Fixed income investments	-	1,912	-	1,912
Money Market funds	-	1,110	-	1,110
Cash and Cash equivalents	<u>70</u>	=	=	<u>70</u>
Total	3,054	3,022	-	6,076

Pension Plan	December 31,	December 31,
(\$ thousands)	2016	2015
Project Benefit Obligation		
Balance beginning of year	7,318	7,695
Interest Cost	327	306
Actuarial (gains)/ losses	(384)	(602)
Benefit payments	<u>(96)</u>	(81)
Balance end of year	7,165	7,318
Plan Assets		
Fair value, beginning of year	6,076	6,280
Actual return on plan assets	88	(281)
Employer contributions to plan	61	158
Benefit payments	<u>(96)</u>	<u>(81)</u>
	6,129	6,076
Funded Status - deficit	(1,036)	(1,242)
During the year ended December 31, 2016 \$0.2 million (December 31, 2015:		
\$0.2 million) was recorded as compensation expense, which comprises the		
following:		
Interest cost	327	306
Expected return on plan assets	(308)	(319)
Amortization of past service costs	-	-
Amortization of actuarial losses	<u>223</u>	<u>206</u>
	242	193
Significant assumptions used:		
Discount rate during year (%)	4.50	4.00
Discount rate at year end (%)	4.30	4.50
Rate of compensation increase (%)	3.00	3.00
Expected long-term rate of return on plan assets (%)	5.00	5.00
Average remaining service period (years)	1.00	2.00

The Accumulated Benefit Obligation ("ABO") as at December 31, 2016 was \$7.0 million (December 31, 2015: \$6.5 million).

The following table summarizes the employee future benefit assets and liabilities and their classification in the balance sheet:

Employee Future Benefit Assets and Liabilities						
(\$ thousands)	December 31, 2016	December 31, 2015				
Assets:						
Other assets	-	-				
Liabilities:						
Defined benefit pension liabilities	1,036	1,242				

The following tables provide the components of other comprehensive loss for the years ended December 31, 2016 and 2015:

Other Comprehensive Income/(Loss)		
(\$ thousands)		
	December 31, 2016	December 31, 2015
Net income arising during the period	165	2
Amortization or curtailment recognition of past service cost	-	-
Amortization or settlement recognition of net actuarial gain	<u>223</u>	<u>206</u>
Total changes recognised in other comprehensive income/ (loss)	388	208

The Company's unrecognised amounts included in accumulated other comprehensive income (loss) yet to be recognised as components of the net periodic benefit cost are as follows:

(\$ thousands)		
	December 31, 2016	December 31, 2015
Past service credit (cost)	-	-
Net actuarial (loss)	(790)	(1,178)
Accumulated other comprehensive loss at year end	(790)	(1,178)
Cumulative employer contributions in excess of net periodic benefit cost	(246)	<u>(64)</u>
Net liability amount recognised in statement of financial position	1,036	(1,242)

Net actuarial losses of \$0.1 million and past service costs of nil are expected to be amortized from accumulated other comprehensive loss into net benefit costs in 2017.

During 2017, the Company is expected to make contributions of \$0.1 million to the defined benefit pension plan.

The following table provides the amount of benefit payments expected to be paid by the plan for each of the following years:

(\$ millions)	
	Total
2017	0.09
2018	0.33
2019	0.34
2020	0.34
2021	0.35
2022-2026	1.82

# 19. Foreign Exchange

The closing rate of exchange on December 30, 2016 as reported by the Bank of Canada for the conversion of US dollars into Canadian dollars was Cdn\$1.3427 per US\$1.00. The official exchange rate for the conversion of Cayman Islands dollars into US dollars as determined by the Cayman Islands Monetary Authority is fixed at CI\$1.00 per US\$1.20. Thus, the rate of exchange as of December 30, 2016 for conversion of Cayman Islands dollars into Canadian dollars was Cdn\$1.6112 per CI\$1.00 (December 31, 2015: Cdn\$1.6608).

# 20. Related Party Transactions

Miscellaneous receivables from Newfoundland Power, a subsidiary of Fortis Inc., was \$10,526 at December 31, 2016 (nil as at December 31, 2015) for travel expenses. Miscellaneous payables to Fortis Inc., the Company's majority shareholder was \$4,485 at December 31, 2016 (\$3,300 as at December 31, 2015) for travel expenses, hurricane preparedness, membership fees and insurance premiums. The Company rents office facilities from a related party, Adare Investments Ltd., on a 5 year lease agreement ending June 30, 2019. Rent costs paid to Adare Investments Ltd. for Fiscal 2016 totaled \$91,596.

# 21. Taxation

Under current laws of the Cayman Islands, there are no income, estate, corporate, capital gains or other taxes payable by the Company.

The Company is levied custom duties of \$0.30 per IG of diesel fuel it imports. In addition, the Company pays customs duties of 15% on all other imports.

# 22. <u>Commitments</u>

As at December 31, 2016, the Company's consolidated commitments in each of the next five years and for periods thereafter are as follows:

(\$millions)					
	Total	2017	2018-2019	2020-2021	2022 Onward
Accounts payable and accrued expenses	23.4	23.4	-	-	-
Consumer's deposits and advances for construction	10.2	10.2	-	-	-
Letter of credit	0.5	0.5	-	-	-
Short term debt	30.0	30.0	-	-	-
Long term debt	224.0	11.0	29.4	29.0	154.6
Long term debt interest	<u>88.2</u>	<u>11.0</u>	<u>19.4</u>	<u>15.7</u>	<u>42.1</u>
Total	376.2	86.0	48.8	44.7	196.7

The Company has a primary fuel supply contract with RUBiS Cayman Islands Limited ("RUBiS"). Under the agreement the Company is committed to purchase approximately 60% of its diesel fuel requirements for its generating plant from RUBiS. The Company also has a secondary fuel supply contract with Sol Petroleum Cayman Limited ("Sol") and is committed to purchase approximately 40% of the Company's fuel requirements for its generating plant from Sol. Contracts with RUBiS and Sol were executed in September 2012. Both contracts expired on July 31, 2014 with the option to renew for two additional 18 month terms. The Company executed 18 month fuel supply contracts in September 2014 upon the expiration of its previous fuel supply contract with both RUBiS and Sol. The Company renewed its contract with RUBiS on September 1, 2016 for the final term which expires on August 31, 2017. The approximate remaining quantities per the fuel contract on an annual basis are, by fiscal year in millions of IGs: 2017 – 13.4. The contract with Sol was renewed for the final term on March 1, 2016 which expires on August 31, 2017. The approximate remaining quantities per the fuel contract on an annual basis are, by fiscal year in millions of IGs: 2017 – 8.9. Both contracts qualify for the Normal Purchase Normal Sale exemption under ASC 815 and do not qualify as derivatives.

The point of delivery for fuel billing purposes remains at the Company's North Sound Plant compound. The Company is also responsible for the management of the fuel pipeline and ownership of bulk fuel inventory at the North Sound Plant

As a result of the Company's bulk fuel inventory, the value of CUC's closing stock of fuel at December 31, 2016 was \$2.3 million (December 31, 2015: \$1.4 million). This amount includes all fuel held in CUC's bulk fuel storage tanks, service tanks and day tanks located at the North Sound Road Power Plant.

# 23. <u>Comparative Figures</u>

Certain comparative figures have been reclassified to conform with current year disclosure.

Ten-Year Summary
(Except where noted, expressed in thousands of United States Dollars)

	2016	2015
Operating Revenues	161,702	188,880
Other revenues and adjustments	5,079	4,876
Total revenues	166,781	193,756
Operating expenses	134,802	163,613
Income before interest	31,979	30,143
Finance Charges	6,768	7,301
Earnings for the year	25,211	22,842
Capitalisation:		
Class A Ordinary Shares (nominal value)	1,943	1,927
9% Cumulative Participating Class B Preference Shares (nominal value)	250	250
Share Premium	119,096	116,201
Long-term loans	222,746	236,594
Total capitalisation	344,035	354,972
Capital expenditures	47,207	77,947
Earnings per Class A Ordinary Share (\$/Share)	0.75	0.71
Dividends per Class A Ordinary Share (\$/Share)	0.675	0.66
Book value per Class A Ordinary (\$/Share)	6.74	6.62
Statistical Record:		
Net kWh generation (millions of kWh)	650.28	623.7
Net kWh sales (millions of kWh)	606.7	582.0
Peak load (MW) gross	103.4	100.7
Plant capacity (MW)	160.95	131.65
Total customers (actual number)	28,678	28,204

Ten-Year Summary
(Except where noted, expressed in thousands of United States Dollars)

2014	2013	2012	2011	2010	2009	TP 2008	2008
231,705	226,220	223,549	218,099	180,096	158,809	150,348	175,981
4,602	4,300	4,199	4,032	3,108	3,109	2,526	3,016
236,307	230,520	227,748	222,131	183,204	161,918	152,874	178,997
206,377	201,080	200,932	193,082	154,182	134,834	135,122	144,673
29,930	29,440	26,816	29,049	29,022	27,084	17,752	34,324
9,115	9,018	9,125	8,659	9,143	7,071	5,153	10,564
20,815	20,422	17,691	20,390	19,879	20,013	12,599	23,760
1,742	1,730	1,715	1,704	1,694	1,683	1,672	1,513
250	250	250	250	250	250	250	250
83,044	81,023	78,524	76,806	75,355	73,729	72,092	43,216
252,000	219,000	188,500	204,000	178,290	200,159	174,643	184,790
337,036	302,003	268,989	282,760	255,589	275,821	248,657	229,769
39,472	29,323	30,788	39,624	21,433	42,665	27,981	44,617
0.68	0.68	0.58	0.68	0.67	0.67	0.45	0.90
0.66	0.66	0.66	0.66	0.66	0.66	0.495	0.66
6.14	6.13	6.03	6.04	6.07	5.90	5.87	5.41
604.7	595.6	587.1	594.0	593.5	597.4	400.7	578.4
564.2	555.7	547.8	554.0	553.8	558.1	376.6	539.6
99.7	97.4	95.9	99.0	102.1	97.5	93.8	92.7
131.65	149.54	149.54	151.2	151.2	152.6	136.6	136.6
27,784	27,364	27,035	26,636	26,151	25,461	24,518	24,041

# **Board of Directors**



Standing:

# **Gary Smith**

President and Chief Executive Officer Newfoundland Power Inc. Newfoundland Canada

# J. Bryan Bothwell, MBE \*

Retired Banking Executive Grand Cayman

# Earl A. Ludlow ^

Executive Vice President Fortis Inc. Newfoundland Canada

# Lynn R. Young

President and Chief Executive Officer Belize Electric Company Ltd. Belize

# Woodrow Foster ^

Managing Director Foster's Food Fair IGA Grand Cayman

# Peter A. Thomson

Retired Executive Caribbean Utilities Company, Ltd. Grand Cayman Seated:

# **Eddinton M. Powell, JP \***

President and Chief Operating Officer Fortis TCI Providenciales Turks & Caicos Islands

# David E. Ritch, OBE, JP \*^

Chairman of the Board of Directors Caribbean Utilities Company, Ltd. Attorney-at-Law Ritch and Conolly Grand Cayman

# J.F. Richard Hew

President and Chief Executive Officer Caribbean Utilities Company, Ltd. Grand Cayman

# Sheree L. Ebanks \*

Chief Executive Officer Cayman Islands Institute of Professional Accountants Grand Cayman

- \* Member Audit Committee (Chairman: J. Bryan Bothwell)
- ^ Member Nominating and Corporate Governance Committee (Chairman: David E. Ritch)

# Officers



# Sacha N. Tibbetts

Vice President Customer Services & Technology

# J.F. Richard Hew

President & Chief Executive Officer

# Letitia T. Lawrence

Vice President Finance, Corporate Services & Chief Financial Officer

# David C. Watler

Vice President Operations

# Shareholder and Corporate Information

#### Shareholders

Registered shareholders as of December 31, 2016 were as follows:

Class of Shares	Shareholders	Shares Held
Class A Ordinary Shares	1,929	32,647,278
9% Class B Preference Shares	122	250,000

Fortis Energy (Bermuda) Ltd., a wholly-owned subsidiary of Fortis Inc., held 19,460,326 Class A Ordinary Shares, or 60% of the outstanding shares as of December 31, 2016. Approximately 12% of the outstanding registered shares are held by residents of the Cayman Islands. Holders of Class B Preference Shares are primarily resident in the Cayman Islands.

#### **Annual General Meeting**

Shareholders are invited to attend the Annual General Meeting of the Company to be held on Thursday, May 11, 2017 at noon at the Marriott Beach Resort on West Bay Road, Grand Cayman. If you are unable to attend, please complete and return the form of proxy in accordance with the instructions set out in the accompanying meeting material.

#### **Dividends**

Class A Ordinary Shares:

Quarterly dividends are customarily paid in March, June, September and December. Record dates are normally three weeks prior to payable dates.

# Class B Preference Shares:

Quarterly dividends are paid on the last day of January, April, July and October. Record dates are normally three weeks prior to payable dates.

# **Dividend Reinvestment Plan**

The Company offers a Dividend Reinvestment Plan to Class A Ordinary and Class B Preference shareholders. Dividends may be reinvested in additional Class A Ordinary Shares. A copy of the plan and enrolment form may be obtained by writing or calling either of the Company's Registrar and Transfer Agents (addresses and telephone numbers in right column) or through the Company's website at www.cuc-cayman.com.

#### **Customer Share Purchase Plan**

The Customer Share Purchase Plan ("CSPP") was launched in January 1995 and provides an opportunity for customers resident in Grand Cayman to invest in the Company without paying brokerage commissions or transaction fees. Customers may make cash payments of not less than \$30 (CI\$25) per purchase and up to a total of \$14,400 (CI\$12,000) per calendar year for the purchase of Class A Ordinary Shares. Quarterly cash dividends paid on the shares are reinvested in additional Class A Ordinary Shares under the CSPP. Full details of the CSPP may be obtained from CUC's Customer Service Department or through the Company's website at www.cuc-cayman.com.

# Solicitors Auditors

Appleby Ernst & Young, Ltd.
P.O. Box 190 P.O. Box 510

Crand Cayman KV1 1104 Crand Cayman KV1

Grand Cayman KY1-1104 Grand Cayman KY1-1106 CAYMAN ISLANDS CAYMAN ISLANDS

#### **Principal Bankers**

Scotiabank & Trust (Cayman) Ltd. P.O. Box 689 Grand Cayman KY1-1107 CAYMAN ISLANDS

## **Duplicate Annual Reports**

While every effort is made to avoid duplications, some shareholders may receive extra reports as a result of multiple share registrations. Shareholders wishing to consolidate these accounts should contact the Registrar and Transfer Agents.

# Registrar and Transfer Agents CST Trust Company

P.O. Box 700, Station B Montreal, Quebec, Canada H3B 3K3 North America (toll free): 1-800-387-0825

Direct: (416) 682-3860 Fax: (888) 249-6189

E-mail: inquiries@canstockta.com Website: www.canstockta.com (Acting as principal agent)

## Caribbean Utilities Company, Ltd.

Company Secretary

P.O. Box 38, Grand Cayman KY1-1101, CAYMAN ISLANDS

Telephone: (345) 949-5200 Fax: (345) 949-4621 E-mail: investor@cuc.ky Website: www.cuc-cayman.com

(Acting as co-agent)

# **Toronto Stock Exchange Listing**

The Company's Class A Ordinary Shares are listed for trading in United States funds on the Toronto Stock Exchange. The stock symbol is "CUP.U". There is no income or withholding tax applicable to holders of Class A Ordinary or Class B Preference Shares under the existing laws of the Cayman Islands.

#### **Registered Office**

Caribbean Utilities Company, Ltd. 457 North Sound Road P.O. Box 38, Grand Cayman KY1-1101, CAYMAN ISLANDS Telephone: (345) 949-5200

Fax: (345) 949-4621 E-mail: investor@cuc.ky

Website: www.cuc-cayman.com

# **Credits:**

Photography:

Neil Murray Caribbean Utilities Company, Ltd.

Miguel Escalante photoctr@candw.ky Grand Cayman, Cayman Islands



# Caribbean Utilities Company, Ltd.

457 North Sound Road

P.O. Box 38 Grand Cayman KY1-1101 CAYMAN ISLANDS

Tel (345) 949-5200 Fax (345) 949-5203 investor@cuc.ky www.cuc-cayman.com





