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May 2 2017 For Immediate Release

**CUC Announces First Quarter Results for the Period Ended March 31 2017** 

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 unaudited results for the three months ended March 31st

2017 ("First Quarter 2017"). (All figures in United States dollars).

Operating income for First Quarter 2017 totalled \$5.4 million, an increase of \$0.3 million when

compared to operating income of \$5.1 million for the three months ended March 31st, 2016

("First Quarter 2016"). The increase is attributable to a 1% increase in kilowatt hour ("kWh")

sales and lower maintenance expenses resulting from lower overtime costs in First Quarter 2017.

Overtime costs in 2016 were impacted by a series of system outages that occurred prior to the

completion of the Company's 40 MW power plant in June 2016. These items were partially

offset by higher depreciation costs.

Despite the factors positively impacting operating income, net earnings decreased \$0.5 million

from \$5.0 million in First Quarter 2016 to \$4.5 million in First Quarter 2017. This was due

primarily to a \$1.0 million increase in Finance charges in First Quarter 2017. This increase in

Finance charges was as a result of a reduction in Allowance for Funds Used During Construction

("AFUDC") upon completion of the 40 MW power plant 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.

During 2014-2016 the Company invested \$79 million to provide this new world class power

plant. The new engine room houses two 18.5 MW diesel generating units, one 2.7 MW waste

Caribbean Utilities Company, Ltd.

457 North Sound Road, P.O. Box 38, Grand Cayman KY1-1101, CAYMAN ISLANDS



heat recovery steam turbine, and associated auxiliary equipment. While the financing costs and depreciation associated with this investment has negatively impacted the First Quarter 2017 earnings when compared to First Quarter 2016, customers have been benefitting from the improved reliability and fuel efficiency which comes with the new engines.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the First Quarter 2017 were \$4.3 million, or \$0.13 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$4.9 million or \$0.15 per Class A Ordinary Share for the First Quarter 2016.

Sales for First Quarter 2017 totalled 136.6 million kWh, an increase of 1.0 million kWh in comparison to 135.6 million kWh for First Quarter 2016. This 1% increase in sales growth was driven by an increase in customer numbers.

For the period under review, total customers were 28,764, an increase of 432 customers, or 2%, compared to 28,332 customers as at March 31, 2016.

President and CEO, Mr. Richard Hew states, "I am pleased with the positive results we have seen during First Quarter 2017 including increased sales, customer numbers and operating income, and the celebration of 730 days without a Lost Time Injury. The Company's earnings results are in-line with expectations due to the additional costs associated with the new generation plant. We will remain focused on delivering strong performances so that our customers and shareholders can benefit. Our teams continue to work hard to ensure that we remain focused on safety, efficiency and productivity. We will also continue to invest in our employees and our infrastructure so that customers can be provided with a safe and reliable electricity service at good value for money."

Capital expenditures for the First Quarter 2017 totalled \$9.4 million consisting primarily of additions and upgrades to CUC's generation and transmission and distribution system to meet customer growth on Grand Cayman.



During the First Quarter 2017 the Company closed on the first tranche of a debt offering in the amount of US\$40 million of an aggregate US\$60 million private placement at favourable rates. The second tranche of US\$20 million is scheduled to close in May 2017. The debt offering was privately placed with institutional investors in the United States. Proceeds from the offering will be used to repay short-term indebtedness and to finance ongoing capital expenditures.

With the 30 cents per imperial gallon Government reduction in fuel duty which took effect in 2016 and improved fuel efficiency from the new plant, customers have benefited from significantly reduced electricity costs during the First Quarter 2017. The residential consumer who used 1,000 kWh per month would have seen their monthly bills decline by approximately CI\$15 during the First Quarter 2017 when compared to the same period in 2016.

On a monthly basis, CUC submits information regarding its fuel costs and its calculation of the per kWh rate used to recover those fuel costs to the Utility Regulation and Competition Office ("OfReg") to be reviewed in advance of billing customers. The fuel costs are recovered from electricity consumers two months in arrears in order to allow for a thorough review process by OfReg. For example, fuel costs incurred in March are billed to consumers in May.

The Company's average price per Imperial Gallon of fuel for the First Quarter 2017 increased 21% to \$2.57, compared to \$2.13 for the First Quarter 2016. The Company's average price per IG of lubricating oil for the First Quarter 2017 decreased to \$9.36 when compared to \$11.49 for the First Quarter 2016. However, the average Fuel Cost Charge rate billed to consumers for the First Quarter 2017 declined 13% to \$0.13 per kWh, compared to the average Fuel Cost Charge rate of \$0.15 per kWh for the First Quarter 2016.

While current fuel prices remain reasonably low, historically, the world fuel market has been volatile and the Company remains committed to connecting other stable and competitively priced energy options to the grid.



During First Quarter 2017 the Customer Owned Renewable Energy Generation ("CORE") programme's limit of 6 megawatts ("MW") was reached. CUC and OfReg are currently in discussions to agree the appropriate way forward for the CORE programme.

Work also continues on the 5 MW Solar Project at Bodden Town. CUC has completed the interconnection facilities for the project including a new 13 Kilovolts ("kV") line. The developer, Entropy Cayman Solar Limited, anticipates that this project will be completed by the Second Quarter 2017.

CUC's First Quarter results and related Management's Discussion and Analysis ("MD&A") for the period ended March 31<sup>st</sup> 2017 are attached to this release.

The MD&A section of this report contains a discussion of CUC's unaudited 2017 First Quarter results, the Cayman Islands economy, liquidity and capital resources, capital expenditures and the business risks facing the Company. The release and First Quarter 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.

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Caribbean Utilities Company, Ltd.

# **2017 First Quarter Report**

March 31, 2017







## 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.

## Caribbean Utilities Company, Ltd.

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## Fellow Shareholders,

We are pleased to report the Company's results for the first three months of 2017. The combination of increased operating income, sales and customer numbers, and the celebration of 730 days without a Lost Time Injury were positive outcomes during the period under review.

Operating income for First Quarter 2017 totalled \$5.4 million, an increase of \$0.3 million when compared to operating income of \$5.1 million for the three months ended March 31st, 2016 ("First Quarter 2016"). The increase is attributable to a 1% increase in kilowatt hour ("kWh") sales and lower maintenance expenses resulting from lower overtime costs in First Quarter 2017. Overtime costs in 2016 were impacted by a series of system outages that occurred prior to the completion of the Company's 40 MW power plant in June 2016. These items were partially offset by higher depreciation costs.

Despite the factors positively impacting operating income, net earnings decreased \$0.5 million from \$5.0 million in First Quarter 2016 to \$4.5 million in First Quarter 2017. This was due primarily to a \$1.0 million increase in Finance charges in First Quarter 2017. This increase in Finance charges was as a result of a reduction in Allowance for Funds Used During Construction ("AFUDC") upon completion of the 40 MW power plant 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.

During 2014-2016 the Company invested \$79 million dollars in capital expenditure to provide this new first-class power plant. The engine room houses two 18.5 MW diesel generating units, one 2.7 MW waste heat recovery steam turbine, and associated auxiliary equipment. While this investment has negatively impacted the First Quarter 2017 earnings when compared to First Quarter 2016, customers have been benefitting significantly from the improved reliability and fuel efficiency which is the result of having the new engines in operation.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the First Quarter 2017 were \$4.3 million, or \$0.13 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$4.9 million or \$0.15 per Class A Ordinary Share for the First Quarter 2016.

Sales for First Quarter 2017 totalled 136.6 million kWh, an increase of 1.0 million kWh in comparison to 135.6 million kWh for First Quarter 2016. This 1% increase in sales growth was driven by an increase in customer numbers.

For the period under review, total customers were 28,764, an increase of 432 customers, or 2%, compared to 28,332 customers as at March 31, 2016.

With the 30 per imperial gallon cents Government reduction in fuel duty which took effect in 2016 and improved fuel efficiency from the new plant, customers have benefited from significantly reduced electricity costs during the First Quarter 2017. The residential consumer who used 1,000 kWh per month would have seen their monthly bills decline by approximately CI\$15 during the First Quarter 2017 when compared to the same period in 2016.

On a monthly basis, CUC submits information regarding its fuel costs and its calculation of the per kWh rate used to recover those fuel costs to the Utility Regulation and Competition Office ("OfReg") to be reviewed in advance of billing customers. The fuel costs are recovered from electricity consumers two months in arrears in order to allow for a thorough review process by OfReg. For example, fuel costs incurred in March are billed to consumers in May.

The Company's average price per Imperial Gallon ("IG") of fuel for the First Quarter 2017 increased 21% to \$2.57, compared to \$2.13 for the First Quarter 2016. The Company's average price per IG of lubricating oil for the First Quarter 2017 decreased to \$9.36 when compared to \$11.49 for the First Quarter 2016.

While current fuel prices remain reasonably low, historically, the world fuel market has been volatile and the Company's efforts to connect other stable and competitively priced energy options to the grid have not been deterred.

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 completed the interconnection facilities for the project including installing a new 13 kiloVolt ("kV") line along the Bodden Town bypass road. This 5 MW Solar Farm is scheduled for completion by Second Quarter 2017 and will provide sufficient energy to approximately 800 homes with clean renewable solar energy and will reduce emissions into the atmosphere through the avoidance of diesel fuel consumption.

During the period under review the Customer Owned Renewable Energy Generation ("CORE") programme's limit of 6 megawatts ("MW") was reached. CUC and OfReg are currently in discussions to agree the appropriate way forward for the CORE programme.

The Cayman Islands Government approved the National Energy Policy 2017-2037 in February 2017. The objective of the policy is to ensure the security, reliability and affordability of energy supplies in Grand Cayman and to reduce the carbon footprint and diversify power sources.

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 system such as what we have in Grand Cayman. The CUC system Average Service Availability Index was 99.92% for the First Quarter 2017.

I am pleased with the positive results recorded by the Company in this First Quarter 2017. We remain focused on controlling our operating expenditures, becoming a more efficient Company and on meeting the future energy needs of Grand Cayman.

J.F. Richard Hew

President & Chief Executive Officer

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May 2, 2017

#### **Interim 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 twelve months 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, weather and the Rights Offering. 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 interim report were approved by the Audit Committee.

May 2, 2017

## **Financial and Operational Highlights**

(\$ thousands, except basic earnings per ordinary share, dividends paid per ordinary share and where otherwise indicated)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Electricity Sales Revenues	18,149	18,061	88	0%
Fuel Factor Revenues	20,170	21,671	(1,501)	-7%
Operating Revenues	38,319	39,732	(1,413)	-4%
Fuel and Lube Costs	20,170	21,671	(1,501)	-7%
Other Operating Expenses	12,795	12,921	(125)	-1%
Total Operating Expenses	32,965	34,592	(1,627)	-5%
Earnings for the Period	4,461	4,975	(514)	-10%
Cash Flow from Operating Activities	14,050	16,935	(2,885)	-17
Per Class A Ordinary Share:				
Basic Earnings	0.13	0.15	(0.02)	-13%
Dividends Paid	0.170	0.165	0.005	3%
Total Customers	28,764	28,332	432	2%
Total Employees*	207	201	6	3%
Customer per Employee (#)	139	141	(2)	-1%
System Availability (%)	99.92	99.90	0.02	0%
Peak Load Gross (MW)	92.7	92.4	0.3	0%
Millions of kWh:				
Net Generation	146.4	145.3	1.1	1%
Kilowatt-Hour Sales	136.6	135.6	1.0	1%
Sales per employee *Total full time CUC employees	0.66	0.67	(0.01)	-1%

#### \*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 Company is regulated by the Cayman Islands Utility Regulation and Competition Office ("OfReg"), which has the overall responsibility of regulating the electricity, information and communications technology, and the petroleum industries in the Cayman Islands in accordance with the Utility Regulation and Competition Office Law (2016). Effective January 16, 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 Licences.

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 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 0.1% 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. 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.

In December 2016 the ERA approved CUC's 2017-2021 Capital Investment Plan in the amount of \$219 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 \$79.0 million. A total of \$11.6 million was spent in 2014, an additional \$47.9 million was spent during 2015 and \$19.5 million was spent during 2016.

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.

CUC's wholly-owned subsidiary, DataLink, Ltd. ("DataLink"), was granted a licence in 2012 from the ICTA (now referred to as the OfReg) permitting DataLink to provide fibre optic infrastructure and other information and communication technology ("ICT") services to the ICT industry. DataLink is subject to regulation by OfReg in accordance with the terms and conditions of its Licence which currently extends to March 27, 2027. CUC and DataLink have entered into three regulator 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.

#### Sales

Sales for the three months ended March 31, 2017 ("First Quarter 2017") totalled 136.6 million kWh, an increase of 1.0 million kWh in comparison to 135.6 million kWh for the three months ended March 31, 2016 ("First Quarter 2016"). The average monthly temperature for the First Quarter 2017 was 80.0 degrees fahrenheit as compared to an average monthly temperature of 80.2 degrees for First Quarter 2016. The average rainfall in First Quarter 2017 was 0.80 inches in comparison to 1.23 inches in First Quarter 2016. The Company's sales can be positively impacted by warm and dry weather conditions which increase electricity usage. Sales were also impacted by the 1% increase in residential customers in First Quarter 2017 when compared to First Quarter 2016. In First Quarter 2017 the average consumption of commercial customers increased by 1% which has also positively impacted sales.

Total customers as at March 31, 2017 were 28,764, an increase of 432 customers, or 2%, compared to 28,332 customers as at March 31, 2016.

The following tables present customer and sales highlights:

Customers (number)	March 31, 2017	March 31, 2016	Change %
Residential	24,503	24,090	1%
Commercial	<u>4,261</u>	<u>4,242</u>	0%
Total Customers	28,764	28,332	2%

Sales (thousands kWh)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Residential	64,956	64,153	803	1%
Commercial	69,950	69,709	241	0%
Other (street lighting, etc.)	<u>1,699</u>	<u>1,697</u>	<u>2</u>	0%
Total Sales	136,605	135,559	1,046	1%

Average Monthly Consumption per Customer (kWh)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Residential	885	888	-3	0%
Commercial	55,815	55,260	555	1%

## **Earnings**

Operating income for First Quarter 2017 totalled \$5.4 million, an increase of \$0.3 million when compared to operating income of \$5.1 million for the three months ended March 31st, 2016 ("First Quarter 2016"). The increase is attributable to a 1% increase in kilowatt hour ("kWh") sales and lower maintenance expenses resulting from lower overtime costs in First Quarter 2017. Overtime costs in 2016 were impacted by a series of system outages that occurred prior to the completion of the Company's 40 MW power plant in June 2016. These items were partially offset by higher depreciation costs.

Despite the factors positively impacting operating income, net earnings decreased \$0.5 million from \$5.0 million in First Quarter 2016 to \$4.5 million in First Quarter 2017. This was due primarily to a \$1.0 million increase in Finance charges in First Quarter 2017. This increase in Finance charges was as a result of a reduction in Allowance for Funds Used During Construction ("AFUDC") upon completion of the 40 MW power plant 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.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the First Quarter 2017 were \$4.3 million, or \$0.13 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$4.9 million or \$0.15 per Class A Ordinary Share for the First Quarter 2016.

## **Operating Revenues**

Total operating revenues were as follows:

Revenues (\$ thousands)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Residential	8,507	8,392	115	1%
Commercial	9,474	9,477	(3)	0%
Other (street lighting, etc.)	<u>168</u>	<u>192</u>	<u>(24)</u>	-13%
<b>Electricity Sales Revenues</b>	18,149	18,061	88	0%
<b>Fuel Factor Revenues</b>	<u>20,170</u>	<u>21,671</u>	<u>(1,501)</u>	-7%
<b>Total Operating Revenues</b>	38,319	39,732	(1,413)	-4%

Operating revenues for the First Quarter 2017 were \$38.3 million, a decrease of \$1.4 million from \$39.7 million for the First Quarter 2016. The decrease in operating revenues for the three months ended March 31, 2017 was due primarily to lower fuel factor revenues.

Other (street lighting, etc.) revenue for the First Quarter 2017 totalled \$0.2 million, comparable to \$0.2 million for the First Quarter 2016. New street lighting rates were approved by the OfReg with an effective date of March 1, 2017. Lighting rates are not subject

to the RCAM, but the Company can apply to the OfReg for adjustment to the lighting rates on an as-needed basis by submitting appropriate cost justifications. Lighting rates were last adjusted in January 2015.

Electricity sales revenues were \$18.1 million for the First Quarter 2017, comparable to electricity sales revenues for the First Quarter 2016.

Fuel factor revenues for the First Quarter 2017 totalled \$20.2 million, compared to fuel factor revenues of \$21.7 million for the First Quarter 2016. Fuel factor revenues for the First Quarter 2017 decreased due to a lower average fuel cost charge per kWh when compared to the First Quarter 2016. The average Fuel Cost Charge rate billed to consumers for the First Quarter 2017 was \$0.13 per kWh, compared to the average Fuel Cost Charge rate of \$0.15 per kWh for the First Quarter 2016. CUC passes through all fuel costs to consumers on a two-month lag basis with no mark-up.

## **Operating Expenses**

Operating expenses were as follows:

Operating Expenses (\$ thousands)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Power Generation Expenses	21,008	22,719	(1,711)	-8%
General and Administration	2,118	2,086	32	2%
Consumer Service	511	630	(119)	-19%
Transmission and Distribution	548	757	(209)	-28%
Depreciation	7,445	6,768	677	10%
Maintenance	1,201	1,481	(280)	-19%
Amortization of Intangible Assets	<u>134</u>	<u>151</u>	<u>(17)</u>	-11%
<b>Total Operating Expenses</b>	32,965	34,592	(1,627)	-5%

Operating expenses for the First Quarter 2017 totalled \$33.0 million, a \$1.6 million decrease from \$34.6 million for the First Quarter 2016. This decrease was due primarily to lower fuel costs for the First Quarter 2017 when compared to the First Quarter 2016, partially offset by higher depreciation costs.

#### Power Generation

Power generation costs for the First Quarter 2017 decreased \$1.7 million to \$21.0 million when compared to \$22.7 million for the First Quarter 2016. This decrease is as a result of lower fuel and temporary generation costs. Temporary generating units were utilized by the Company during the first half of 2016. All temporary generating units were returned to the supplier by June 2016.

Power	generation	expenses w	ere as	follows:
IOVVCI	Schol actor	CAPCIISCS W	CI C US	IOIIO W.S.

Power Generation (\$ thousands)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Fuel costs (net of deferred fuel charges)	19,826	21,181	(1,356)	-6%
Lubricating Oil costs (net of deferred lubricating oil charges)	344	490	(146)	-30%
Temporary generation costs	-	215	(215)	-100%
Other generation expenses	<u>838</u>	<u>833</u>	<u>5</u>	1%
Total power generation expenses	21,008	22,719	(1,711)	-8%

The Company's average price per Imperial Gallon ("IG") of fuel for the First Quarter 2017 increased 21% to \$2.57, compared to \$2.13 for the First Quarter 2016. The Company's average price per IG of lubricating oil for the First Quarter 2017 decreased to \$9.36 when compared to \$11.49 for the First Quarter 2016.

Net generation was 146.4 million kWh for the First Quarter 2017, a 1% increase when compared to 145.3 million kWh for the First Quarter 2016. Net fuel efficiency for the First Quarter 2017 of 19.59 kWh per IG increased when compared to net fuel efficiency for the First Quarter 2016 of 18.27 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 Note 5 of the consolidated financial statements) 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 Program. The objective of the program 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 2016 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 First Quarter 2016 totalled \$0.2 million and decreased to \$nil in First Quarter 2017. All temporary generating units had been returned to the supplier in June 2016.

Other generation expenses for the First Quarter 2017 totalled \$0.8 million, comparable to other generation expenses of \$0.8 million for the First Quarter 2016.

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

G&A expenses for the First Quarter 2017 totalled \$2.1 million, comparable to G&A expenses for the First Quarter 2016.

General Expenses Capitalised ("GEC") totalled \$1.1 million for the First Quarter 2017, an increase of \$0.1 million when compared to \$1.0 million for the First Quarter 2016.

#### **Consumer Services ("CS")**

CS expenses for the First Quarter 2017 totalled \$0.5 million, a decrease of \$0.1 million when compared to \$0.6 million for the First Quarter 2016. The decrease is due to the reduction in the bad debt expense recorded in First Quarter 2017 in comparison to First Quarter 2016.

Trade and other accounts receivable (\$ thousands)	As at March 31, 2017	As at December 31, 2016
Current	4,568	6,552
Past due 31-60 days	458	592
Past due 61-90 days	315	153
Past due over 90 days	<u>4,931</u>	<u>5,073</u>
Total Accounts Receivable	10,272	12,370
Less: Allowance for doubtful accounts	(1,927)	(1,987)
Less: Consumer Deposits	<u>(7,858)</u>	<u>(7,754)</u>
Trade Receivables less allowance for doubtful accounts and consumer deposits	487	2,629

Trade receivables less allowance for doubtful accounts and consumer deposits as at March 31, 2017 totalled \$0.5 million, a decrease of \$2.1 million, or 80% when compared to \$2.6 million as at December 31, 2016. This decrease was primarily related to a decrease in receivables in the current and past due over 90 day categories. The current and past due over 90 day category of receivables decreased by \$2.0 million and \$0.1 million respectively, or 31% and 3% respectively due to lower fuel factor billings and improved efficiencies in the disconnection process due to the newly installed Advanced Metering Infrastructure ("AMI") meters. 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 the First Quarter 2017 totalled \$0.5 million, a decrease of \$0.3 million compared to T&D expenses for the First Quarter 2016 of \$0.8 million. T&D expenses for the First Quarter 2017 were impacted by an increase in the T&D department's capital projects during First Quarter 2017 when compared First Quarter 2016.

### Depreciation of Property, Plant and Equipment (PP&E)

Depreciation expenses for the First Quarter 2017 totalled \$7.4 million, an increase of \$0.6 million, from \$6.8 million for the First Quarter 2016. The increase in depreciation expenses is due to completed capital projects, including the 40 MW generation expansion project which was installed in June 2016.

#### Maintenance

Maintenance expenses for the First Quarter 2017 totalled \$1.2 million, a decrease of \$0.3 million when compared to \$1.5 million for the First Quarter 2016. This decrease is due to lower overtime costs for ongoing maintenance projects of the generating units.

## **Amortization**

Amortization of intangible assets for the First Quarter 2017 totalled \$0.1 million, a decrease of 0.1 million when compared to \$0.2 million for the First Quarter 2016.

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 the First Quarter 2017 totalled \$0.9 million, an increase of \$0.7 million from \$0.2 million for the First Quarter 2016.

Other Income & Expenses (\$ thousands)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Total interest costs	(3,027)	(3,055)	28	-1%
AFUDC	<u>914</u>	<u>1,912</u>	(998)	-52%
Total finance charges	(2,113)	(1,143)	(970)	85%
Foreign exchange gain Other income Total Net Other Expense	309	307	2	1%
	<u>911</u>	<u>671</u>	<u>240</u>	36%
	(893)	(165)	(728)	441%

Finance charges for the First Quarter 2017 totalled \$2.1 million, a \$1.0 million increase from \$1.1 million for the First Quarter 2016. This increase is as a result of lower AFUDC partially offset by lower interest costs in the First Quarter 2017.

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 CWIP for each month. The cost of capital rate for 2017 was 7.75% (2016:7.75%) as agreed with the OfReg, in accordance with the T&D Licence, and is reviewed annually.

The AFUDC amount for the First Quarter 2017 totalled \$0.9 million, a decrease of \$1.0 million from \$1.9 million for the First Quarter 2016. This decrease was attributable to lower capital expenditure, driven primarily by the generation project completed in 2016.

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 for the First Quarter 2017 totalled \$0.3 million, comparable to the First Quarter 2016.

Other income totalled \$0.9 million for the First Quarter 2017, a \$0.2 million increase when compared to other income of \$0.7 million for the First Quarter 2016.

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.

Revenues from DataLink for the First Quarter 2017 are recorded in Other Income in the amount of \$0.4 million, an increase of \$0.2 million when compared to Other Income of \$0.2 million for the First Quarter 2016.

## The Economy

In February 2017, the Cayman Islands Government released the 2016 Consumer Price Index ("CPI") Report. The average CPI for 2016 decreased 0.6% from the average CPI in 2015. This decrease was the result of decreasing inflation in the first and second quarters of 2016, the highest being seen in the first quarter at 2.8%. Of the 12 divisions monitored in the CPI calculation, four divisions saw price declines in 2016: Housing & Utilities, Transport, Household Equipment and Health. The divisions with the largest increases were Restaurants & Hotels and Education.

According to the 2016 Third Quarter Economic Report from the Cayman Islands Economics and Statistics office ("ESO") that was released in February 2017, overall economic activity in the Cayman Islands grew by an estimated 2.8% in the first nine months of 2016 compared to 2015. According to the report, construction led the growth, and growth rates were indicated for a number of other sectors including wholesale and retail trade, repairs & installation of machinery, electricity and water, mining & quarrying and transport, storage & communication. GDP growth for 2016 is forecasted at 3.0%. The ESO is forecasting Annual GDP growth of 2.3% for 2017. The Company's annual sales growth and resource requirements, including number of employees, have historically been heavily influenced by changes in the level of economic activity in the country as illustrated by the GDP.

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

	As at March 31, 2017	As at December 2016	As at December 2015	As at December 2014	As at December 2013
Bank Licences	158	159	184	198	213
Mutual Funds *	10,463	10,586	10,940	11,010	11,379
Mutual Fund Administrators	103	106	108	115	121
Registered Companies	99,393	96,248	98,838	99,459	95,530
Captive insurance companies	732	740	739	793	788

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.

First Quarter 2017 air arrivals were lower by 1.4% when compared to 2016 and cruise arrivals saw a decrease of 6.7% when compared to 2016. Air arrivals have a direct impact on the Company's sales growth as these visitors are stay-over visitors who occupy local

accommodation services. 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 three months ending March 31:

Arrivals	2017	2016	2015	2014	2013
By Air	111,237	112,778	115,640	109,406	104,029
By Sea	571,313	612,150	544,073	543,017	532,263
Total	682,550	724,928	659,713	652,423	636,292

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.

All data is sourced from the Cayman Islands Government, Cayman Islands Economics & Statistics Office, Cayman Islands Monetary Authority, Cayman Financial Review, Cayman Islands Department of Tourism and Health City websites; www.gov.ky <a href="www.caymanslands.ky">www.caymanslands.ky</a> www.caymanslands.com.

## Liquidity

The following table outlines the summary of the Company's cash flows:

Cash Flows (\$ thousands)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Change	% Change
Beginning cash	9,861	1,365	8,496	622%
Cash provided by/(used in):				
Operating activities	14,050	16,935	(2,885)	-17%
Investing activities	(9,450)	(10,668)	1,218	11%
Financing activities	<u>4,853</u>	<u>(4,485)</u>	<u>9,338</u>	208%
Ending cash	19,314	3,147	16,167	514%

## Operating Activities:

Cash flow provided by operations, after working capital adjustments, for the First Quarter 2017, was \$14.0 million, a \$2.9 million decrease when compared to \$16.9 million for the First Quarter 2016. This decrease was primarily due to changes in regulatory deferrals which was partially offset by higher accounts payables and accrued expenses.

## *Investing Activities:*

Cash used in investing activities for the First Quarter 2017 totalled \$9.4 million, a decrease of \$1.2 million from \$10.7 million for the First Quarter 2016. This decrease is due to lower capital expenditures.

## Financing Activities:

Cash provided by financing activities for the First Quarter 2017 totalled \$4.9 million, an increase of \$9.4 million compared to cash used in financing activities of \$4.5 million for the First Quarter 2016. The increase in cash provided by financing activities is attributable to the issuance of long term debt in First Quarter 2017 which was partially offset by the full repayment of the short term debt in First Quarter 2017.

## 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).

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

Miscellaneous payables to Fortis Inc., the Company's majority shareholder, was \$11,856 at March 31, 2017 (\$4,485 as at December 31, 2016) for travel expenses, hurricane preparedness, membership fees and insurance premiums. Miscellaneous receivables from Newfoundland Power, a subsidiary of Fortis Inc., was \$10,526 at March 31, 2017 (10,526 as at December 31, 2016) for travel expenses. The Company rents office facilities from a related party, Adare Investments Ltd., on a 5 year lease agreement ending June 30, 2019; rent totalled \$22,900 for the three months ended March 31, 2017.

## **Contractual Obligations**

The contractual obligations of the Company over the next five years and periods thereafter, as at March 31, 2017, are outlined in the following table:

(\$ millions)	Total	< 1 year	1 to 3 years	4 to 5 years	> 5 years
Total debt	264.00	11.00	29.43	28.99	194.58
Long-term debt interest	106.42	12.04	22.51	18.80	53.07
Defined benefit pension	<u>0.02</u>	0.02	<u>=</u>	=	=
Total	370.44	23.06	51.94	47.79	247.65

## 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 - 8.7. 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 – 5.8. 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, 2016 to March 31, 2017:

Significant changes in Balance Sheets between December 31, 2016 and March 31, 2017 (\$ millions)	Increase/ (Decrease)	Explanation
Cash and Cash Equivalents	9.5	Increase due to cash provided by operating activities of \$14.0 million and cash provided by financing activities of \$4.9 million, partially offset by cash used in investing activities of \$9.4 million.
Accounts Receivable	(2.0)	Lower fuel billings due to a decrease in fuel costs and increased collections efforts.
Regulatory Assets	1.6	Increase attributable to higher deferred fuel costs.
Prepayments	(1.1)	Decrease due to recognition of \$0.8 in expenses associated with the Company's property and machinery breakdown insurance policy and \$0.4 decrease in inventory prepayments.
Property, Plant and Equipment	3.8	Net increase is comprised of capital expenditures of (1) \$9.4 million (2) depreciation expense of \$7.4 million (3) \$1.8 million in accrued capital expenditure.
Accounts Payable and Accrued Expenses	2.7	Change mainly attributable to Funds in Aid of Construction, increased accrued interest partially offset by lower fuel payable and dividends paid during the quarter
Short-term Debt	(30.0)	Full repayment of short-term debt during the period.
Long-term Debt	39.9	Increase due to \$40 million in debt proceeds received in March 2017.
Share Premium	1.0	The Company issued 82,981 shares through its share purchase plans. $ \\$

### **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 March 31, 2017, the Company was in compliance with all debt covenants.

The Company's capital	structure is present	ed in the following table:
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Capital Structure	March 31, 2017 (\$ millions)	%	December 31, 2016 (\$ millions)	%
Total debt	262.7	54	252.7	53
Shareholder's equity	<u>219.9</u>	<u>46</u>	<u>220.0</u>	<u>47</u>
Total	482.6	100	472.7	100

The change in the Company's capital structure between December 31, 2016 and March 31, 2017 was driven by higher total debt and a decrease in shareholder's equity of \$0.1 million.

During the First Quarter 2017 the Company closed on the first tranche in the amount of US\$40 million of an aggregate US\$60 million private placement at favourable rates. The second tranche of US\$20 million is scheduled to close in May 2017. The debt offering was privately placed with institutional investors in the United States. Proceeds from the offering will be used to repay short-term indebtedness and to finance ongoing capital expenditures. For First Quarter 2017, shareholder's equity decreased by \$0.1 million to \$219.9 million when compared to \$220.0 million as at December 31, 2016. This decrease was primarily due to lower retained earnings which was partially offset by an increase in equity resulting from the issuance of Class A Ordinary Shares through the Company's share purchase plans.

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 2017, 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.

#### **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:

Credit Facilities	(\$ 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, \$49.0 million was available at March 31, 2017.

## Capital Expenditures

Capital expenditures for the three months ended March 31, 2016 were \$9.4 million, a \$1.3 million, or 12% decrease from \$10.7 million in capital expenditures for the three months ended March 31, 2016. The capital expenditures for the three months ended March 31, 2017 primarily relate to:

- Distribution system extension and upgrades \$3.7 million.
- Generation Replacement Cost \$3.7 million
- REC 580 Retrofit North Sound \$0.5 million
- Facility Asset Replacement & Upgrades -\$0.3 Million
- AFUDC of \$0.9 million was capitalized in the three months ended March 31, 2017

Capital expenditures (\$ Millions)	Three months ended March 31, 2017	Three months Ended March 31, 2016
Transmission	0.8	0.4
Distribution	3.7	3.5
Generation	4.5	6.1
Other	<u>0.4</u>	<u>0.7</u>
Total	9.4	10.7

## **Off Balance-Sheet Arrangements**

Disclosure is required of all 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. The Company has no such off-balance sheet arrangements as at March 31, 2017.

#### **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 OfReg for recovery of these costs through higher rates. However, there is no assurance that the OfReg 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 OfReg 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 OfReg.

## 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 recertification. Internal audits of the system must also be conducted on an annual basis. CUC has most recently conducted, and passed its re-certification 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 2017 is 5%. This compares to assumed long-term rates of return of 5% used during 2016. 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 2017 is 4.3% compared to the discount rate assumed during 2016 of 4.5%.

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 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 nil.

#### **FUTURE ACCOUNTING POLICIES**

The Company considers the applicability and impact of all ASUs issued by the Financial Accounting Standards Board ("FASB"). The following updates have been issued by FASB, but have not yet been adopted by the Company. Any ASUs not included below were assessed and determined to be either not applicable to the Company or are not expected to have a material impact on the consolidated financial statements.

#### *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 has elected not 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 interpretative issues that remain outstanding. Any significant developments in interpretative issues 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 from transmission services 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; however, the Company does expect it will impact its required disclosures. Certain specific interpretative issues 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 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.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, was issued in March 2017 and the amendments in this update require that an employer disaggregate the current service costs component of net benefit cost and present it in the same statement of earnings line item(s) as other employee compensation costs arising from services rendered. The other components of net benefit cost are required to be presented separately from the service cost component and outside of operating income. Additionally, the amendments allow only the service cost component to be eligible for capitalization when applicable. This update is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied retrospectively for the presentation of the net periodic benefit costs and prospectively, on and after the effective date, for the capitalization in assets of only the service cost component of net periodic benefit costs. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

## **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 March 31, 2017, the amount of unbilled revenue recorded in Electricity Sales was \$1.8 million (March 31, 2016: \$2.3 million).

## Kilowatt Hour ("kWh") Sales

KWh 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 March 31, 2017, the amount of estimated kWh sales was 11.6 million kWh (March 31, 2016: 17.5 million kWh).

## Employee Future Benefits

The Company's defined benefit pension plan is subject to judgments utilized 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 March 31, 2017, the Company has a long term liability of \$1.1 million (December 31, 2016: \$1.0 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 March 31, 2017, the net book value of the Company's PP&E was \$471.0 million compared to \$467.2 million as at December 31, 2016, increasing as a result of the Company's generation and T&D capital expenditures. Depreciation expense for the First Quarter 2017 was \$7.4 million (\$6.8 million for the First

Quarter 2016). 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.

## **Quarterly Results**

The table "Quarterly Results" summarises unaudited quarterly information for each of the eight quarters ended June 30, 2015 through March 31, 2017. 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 and diluted earnings per ordinary share)	Operating Revenue	Net earnings	Income applicable to ordinary shares	Earnings per ordinary share	Diluted earnings per ordinary share
March 31, 2017	38,319	4,461	4,348	0.13	0.13
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 2017/March 2016

Operating income for First Quarter 2017 totalled \$5.4 million, an increase of \$0.3 million when compared to operating income of \$5.1 million for the three months ended March 31st, 2016 ("First Quarter 2016"). The increase is attributable to a 1% increase in kilowatt hour ("kWh") sales and lower maintenance expenses resulting from lower overtime costs in First Quarter 2017. Overtime costs in 2016 were impacted by a series of system outages that occurred prior to the completion of the Company's 40 MW power plant in June 2016. These items were partially offset by higher depreciation costs.

Despite the factors positively impacting operating income, net earnings decreased \$0.5 million from \$5.0 million in First Quarter 2016 to \$4.5 million in First Quarter 2017. This was due primarily to a \$1.0 million increase in Finance charges in First Quarter 2017. This increase in Finance charges was as a result of a reduction in Allowance for Funds Used During Construction ("AFUDC") upon completion of the 40 MW power plant 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.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the First Quarter 2017 were \$4.3 million, or \$0.13 per Class A Ordinary Share, compared to earnings on Class A Ordinary Shares of \$4.9 million or \$0.15 per Class A Ordinary Share for the First Quarter 2016.

## 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 was attributable to 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 the three months ended June 30, 2016 ("Second Quarter 2016") totalled \$7.2 million, an increase of \$0.8 million when compared to operating income of \$6.4 million for the three months ended June 30, 2015 ("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.

#### 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 March 31, 2017.

## **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 March 31, 2017.

#### 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.

During the First Quarter 2017 the Company closed on the first tranche in the amount of US\$40 million of an aggregate US\$60 million private placement at favourable rates. The second tranche of US\$20 million is scheduled to close in May 2017. The debt offering was privately placed with institutional investors in the United States. Proceeds from the offering will be used to repay short-term indebtedness and to finance ongoing capital expenditures.

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 is expected to be completed by June 2017 and will give shape to the energy generation plans for Grand Cayman over the next 30 years.

The Cayman Islands Government approved the National Energy Policy 2017-2037 in February 2017. The objective of the policy is to ensure the security, reliability and affordability of energy supplies in Grand Cayman and to reduce the carbon footprint and diversify power sources.

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 May 2, 2017 the Company had issued and outstanding 32,730,259 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 May 2, 2017 is as follows.

Conversion of Securities into Common Shares	Number of
As at May 2, 2017 (Unaudited)	Common Shares
Stock Options	157,100

Additional information, including CUC's Annual Information Form, is available on SEDAR at <a href="https://www.sedar.com">www.sedar.com</a> and on the Company's website at <a href="https://www.cuc-cayman.com">www.cuc-cayman.com</a>.

# **Consolidated Balance Sheets**

 $(expressed\ in\ thousands\ of\ United\ States\ Dollars)$ 

Unaudited	Note	As at March 31, 2017	As at December 31, 2016
Assets			
Current Assets			
Cash and Cash Equivalents		19,314	9,861
Accounts Receivable	4	8,333	10,366
Related Party Receivables	19	11	17
Regulatory Assets	5	15,233	13,605
Inventories	6	3,207	3,136
Prepayments		<u>1,537</u>	<u>2,599</u>
		47,635	39,584
Property, Plant and Equipment	7	471,044	467,214
Other Assets	8	24	24
Intangible Assets	9	<u>2,975</u>	<u>3,039</u>
Total Assets		<u>521,678</u>	<u>509,861</u>
Liabilities and Shareholders' Equity Current Liabilities			
Accounts Payable and Accrued Expenses	10	26,207	23,471
Related Party Payables	19	12	4
Regulatory Liabilities	5	1,009	1,625
Short-Term Debt	12	0	30,000
Current Portion of Long-Term Debt		11,000	11,000
Consumers' Deposits and Advances for Construction		10,283	<u>10,231</u>
		48,511	76,331
Defined Benefit Pension Liability		1,098	1,036
Long-Term Debt	14	251,687	211,746
Other Long term Liabilities	12	<u>433</u>	<u>626</u>
Total Liabilities		301,729	289,739
Shareholders' Equity			
Share Capital		2,198	2,193
Share Premium		120,108	119,096
Additional Paid in Capital	12	467	467
Retained Earnings		97,948	99,156
Accumulated Other Comprehensive Loss		<u>(772)</u>	<u>(790)</u>
Total Shareholders' Equity		219,949	220,122
Total Liabilities and Shareholders' Equity		<u>521,678</u>	<u>509,861</u>

# Caribbean Utilities Company, Ltd.

## **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)

Unaudited	Note	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Operating Revenues			_0_0
Electricity Sales		18,149	18,061
Fuel Factor		20,170	<u>21,671</u>
Total Operating Revenues		38,319	39,732
Operating Expenses			
Power Generation		21,008	22,719
General and Administration		2,118	2,086
Consumer Services		511	630
Transmission and Distribution		548	757
Depreciation		7,445	6,768
Maintenance		1,201	1,481
Amortization of Intangible Assets		<u>134</u>	<u>151</u>
Total Operating Expenses		32,965	34,592
Operating Income		5,354	5,140
Other (Expenses)/Income:			
Finance Charges	16	(2,113)	(1,143)
Foreign Exchange Gain	18	309	307
Other Income		<u>911</u>	<u>671</u>
Total Net Other (Expenses)/Income		(893)	(165)
Earnings for the Period		4,461	4,975
Preference Dividends Paid- Class B		<u>(113)</u>	<u>(113)</u>
Earnings on Class A Ordinary Shares		4,348	4,862
Weighted-Average Number of Class A Ordinary Shares Issued			
and Fully Paid (in thousands)	13	32,659	32,382
Earnings per Class A Ordinary Share	13	0.13	0.15
Diluted Earnings per Class A Ordinary Share	13	0.13	0.15
Dividends Declared per Class A Ordinary Share		0.170	0.165

# Consolidated Statements of Comprehensive Income (expressed in thousands of United States Dollars)

Unaudited	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Earnings for the Period	4,461	4,975
Other Comprehensive Income/(Loss):		
Amounts arising during the period Defined Benefit Pension plans:		
Amortization of net actuarial loss	<u>18</u>	<u>56</u>
Total Other Comprehensive Income	18	56
Comprehensive Income	4,479	5,031

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

Unaudited	Class A Ordinary Shares (in thousands)	Class A Ordinar y Shares Value (\$)	Preferenc e Shares (\$)	Share Premium (\$)	Addition al Paid- in Capital (\$)	Accumulat ed Other Comprehen sive Loss (\$)	Retaine d Earnings (\$)	Total Equity (\$)
As at January 1, 2017	32,647	1,943	250	119,096	467	(790)	99,156	220,122
Net earnings	-	-	-	-	-	-	4,461	4,461
Common share issuance and stock options plans	83	5	-	1,012	-	-	-	1,017
Defined benefit plans	-	-	-	-	-	18	-	18
Dividends on common shares	-	-	-	-	-	-	(5,556)	(5,556)
Dividends on preference shares	-	-	-		-	-	(113)	(113)
As at March 31, 2017	32,730	1,948	250	120,108	467	(772)	97,948	219,949
As at January 1, 2016	32,382	1,927	250	116,201	467	(1,178)	96,822	214,489
Net earnings	-	-	-	-	-	-	4,975	4,975
Common share issuance and stock options plans	43	3	-	523	-	-	-	526
Defined benefit plans	-	-	-		-	56	-	56
Dividends on common shares	-	-	-	-	-	-	(5,343)	(5,343)
Dividends on preference shares	-	-	-	-	-	-	(113)	(113)
As at March 31, 2016	32,425	1,930	250	116,724	467	(1,122)	96,341	214,590

## **Consolidated Statements of Cash Flows**

(expressed in thousands of United States Dollars)

Unaudited	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Operating Activities		-
Earnings for the period	4,461	4,975
Items not affecting cash:		
Depreciation	7,445	6,768
Amortization of Intangible Assets	134	151
Non-cash Pension Expenses	(43)	61
Amortization of Deferred Financing Costs	34	40
Stock-based compensation	=	<u>1</u>
	12,031	11,996
Net change in non-cash working capital balances related to		
operations	4,264	1,706
Net Change in Regulatory Deferrals	(2,245)	<u>3,233</u>
Cash flow related to operating activities	14,050	16,935
Investing Activities		
Purchase of property, plant and equipment	(9,449)	(10,640)
Costs related to intangible assets	(54)	(28)
Contributions in Aid of Construction	<u>53</u>	=
Cash flow related to investing activities	(9,450)	(10,668)
Financing Activities		
Proceeds from debt financing	40,000	-
Repayment of debt	(30,000)	-
Increase in bank overdraft	-	927
Dividends paid	(6,164)	(5,935)
Net proceeds from share issues	<u>1,017</u>	<u>523</u>
Cash flow related to financing activities	4,853	(4,485)
Increase in net cash and cash equivalents	9,453	1,782
Cash and cash equivalents - Beginning of period	<u>9,861</u>	<u>1,365</u>
Cook and each aguivalents. End of paried	19,314	3,147
Cash and Cash equivalents - End of period		
Cash and cash equivalents - End of period Supplemental disclosure of cash flow information:		

#### Notes to Interim Consolidated Financial Statements

*Unaudited – March 31, 2017 (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 Utility Regulation and Competition Office ("OfReg"). 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.

The Company is regulated by the Cayman Islands Utility Regulation and Competition Office ("OfReg"), which has the overall responsibility of regulating the electricity, information and communications technology, and the petroleum industries in the Cayman Islands in accordance with the Utility Regulation and Competition Office Law (2016). Effective January 16, 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 Licences.

CUC's wholly-owned subsidiary, DataLink, Ltd. ("DataLink"), was granted a licence in 2012 from the ICTA (now referred to as the OfReg) permitting DataLink to provide fibre optic infrastructure and other information and communication technology ("ICT") services to the ICT industry. DataLink is subject to regulation by OfReg in accordance with the terms and conditions of its Licence which currently extends to March 27, 2027.

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 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 includes 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.

## Seasonality

Interim results will fluctuate due to the seasonal nature of electricity consumption. In Grand Cayman, demand is highest in the summer months due to air-conditioning load. Consequently, interim results are not necessarily indicative of annual results.

## 2. Summary of Significant Accounting Policies

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.

## 3. 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 has elected not 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 interpretative issues that remain outstanding. Any

significant developments in interpretative issues 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 from transmission services 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; however, the Company does expect it will impact its required disclosures. Certain specific interpretative issues 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 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.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, was issued in March 2017 and the amendments in this update require that an employer disaggregate the current service costs component of net benefit cost and present it in the same statement of earnings line item(s) as other employee compensation costs arising from services rendered. The other components of net benefit cost are required to be presented separately from the service cost component and outside of operating income. Additionally, the amendments allow only the service cost component to be eligible for capitalization when applicable. This update is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The amendments in this update should be applied retrospectively for the presentation of the net periodic benefit costs and prospectively, on and after the effective date, for the capitalization in assets of only the service cost component of net periodic benefit costs. The Company is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

#### 4. Accounts Receivable

Accounts Receivable (\$ thousands)	As at March 31, 2017	As at December 31, 2016
Billings to consumers	7,447	8,915
Unbilled revenues	1,793	2,241
Other receivables	1,020	1,197
Allowance for doubtful accounts	(1,927)	(1,987)
Total accounts receivable	8,333	10,366

#### **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 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. 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 receivables include sale of inventory and machine break-down costs covered by warranties. Other receivables at March 31, 2017 also include billing adjustments for commercial customers.

## 5. Regulatory Assets and Liabilities

Asset/Liability		As at March 31,	As at December 31,
(\$ thousands)	Description	2017	2016
Regulatory Assets	Fuel Tracker Account (a)	14,847	13,244
Regulatory Assets	Derivative contract (b)	147	116
Regulatory Assets	Miscellaneous Regulatory Assets (c)	239	<u>245</u>
<b>Total Regulatory Assets</b>		15,233	13,605
	Government & Regulatory Tracker Account		
Regulatory Liabilities	(d)	(1,009)	(1,625)
<b>Total Regulatory Liabilities</b>		<u>(1,009</u>	(1,625)

- a) Fuel Tracker Account The 2008 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. The Company's current call option contracts will expire in October 2017.
- 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 OfReg.
- 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.

#### 6. Inventories

The composition of inventories is shown in the table below:

Inventories (\$ thousands)	As at March 31, 2017	As at December 31, 2016
Fuel	2,630	2,289
Lubricating Oil	263	524
Line spares	103	104
Datalink, Ltd.	211	211
Other	<u>-</u>	<u>8</u>
Total	3,207	3,136

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

Property, Plant and Equipment (\$ thousands)	Cost	Accumulated Depreciation	Net Book Value March 31, 2017
Transmission & Distribution (T&D)	328,711	123,740	204,971
Generation	418,063	173,577	244,486
Other:			
Land	5,304	-	5,304
Buildings	20,167	11,662	8,505
Equipment, motor vehicles and computers	<u>25,735</u>	<u>18,410</u>	<u>7,325</u>
Total of T&D, Generation and Other	797,980	327,389	470,591
Datalink, Ltd.	<u>542</u>	<u>89</u>	<u>453</u>
Property, plant and equipment	798,522	<u>327,478</u>	471,044

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	<u>25,158</u>	<u>18,044</u>	<u>7,114</u>
Total of T&D, Generation and Other	786,656	319,901	466,755
Datalink, Ltd.	<u>541</u>	<u>82</u>	<u>459</u>
Property, plant and equipment	<u>787,197</u>	<u>319,983</u>	<u>467,214</u>

Included in PP&E are a number of capital projects in progress with a total cost to date of \$41.3 million (December 31, 2016: \$35.9 million). These projects primarily relate to various improvements to the Distribution System. 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, 2016: \$5.0 million). In addition, line inventory with a cost of \$3.8 million (December 31, 2016: \$3.3 million) is included in T&D. Engine spares with a net book value of \$13.5 million (December 31, 2016: \$13.8 million) are included in Generation.

The capitalisation of AFUDC 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 calendar 2017 is 7.75% (2016: 7.75%) and will be adjusted annually. As a result, during the First Quarter 2017, the Company recognised \$0.9 million in AFUDC (First Quarter 2016: \$1.9 million).

GEC is calculated as a percentage of up to 10% of Non-Fuel Operating Expenses, varying annually depending on the level of capital activity. GEC totalled \$1.1 million for the First Quarter 2017, an increase of \$0.1 million when compared to \$1.0 million for the First Quarter 2016.

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 regulation standard under US GAAP and differs from non-regulatory treatment of a loss being recognized 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.

#### 8. Other Assets

Other Assets (\$ thousands)	As at March 31, 2017	As at December 31, 2016
Miscellaneous other assets	<u>24</u>	<u>24</u>
Total	24	24

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

Intangible Assets		Accumulated	Net Book Value
(\$ thousands)	Cost	Amortisation	March 31, 2017
Deferred licence renewal costs	1,890	843	1,047
Datalink Ltd. deferred licence renewal costs	200	67	133
Computer Software	6,663	5,070	1,593
Other Intangible Assets in progress	127	-	127
Trademark Costs	<u>75</u>	<del>-</del>	<u>75</u>
Total	8,955	5,980	2,975
			Net Book Value
			Net Book varae
Intangible Assets		Accumulated	December 31,
Intangible Assets (\$ thousands)	Cost	Accumulated Amortisation	
	<b>Cost</b> 1,890		December 31,
(\$ thousands)		Amortisation	December 31, 2016
(\$ thousands)  Deferred licence renewal costs	1,890	Amortisation 821	December 31, 2016 1,069
(\$ thousands)  Deferred licence renewal costs  Datalink Ltd. deferred licence renewal costs	1,890 200	Amortisation 821 63	December 31, 2016 1,069 137
(\$ thousands)  Deferred licence renewal costs  Datalink Ltd. deferred licence renewal costs  Computer Software	1,890 200 6,594	Amortisation 821 63	December 31, 2016 1,069 137 1,631

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 T & D Licence. Amortization of DataLink's deferred licence renewal costs commenced upon conclusion of licence negotiations in March 2012 and extends over the life of its ICTA licence.

## 10. Accounts Payable and Accrued Expenses

Accounts Payable (\$ thousands)	As at March 31, 2017	As at December 31, 2016
Fuel Cost Payable	12,804	13,175
Trade Accounts Payable & Accrued expenses	4,897	5,323
Accrued Interest	3,752	934
Dividends Payable	112	607
Other Accounts Payable	4,642	<u>3,432</u>
Total Accounts Payable	26,207	23,471

Included in Other Accounts Payable is an amount related to the fuel option contracts (see Note 15) of \$0.1 million at March 31, 2017 (\$0.1 million at December 31, 2016).

# 11. Short-Term Financing

The Company has \$50.0 million of unsecured credit financing facilities with the Scotiabank & Trust (Cayman) Limited ("Scotia") and Royal Bank of Canada ("RBC"). The total available amount was \$49 million at March 31, 2017 (\$19 million at December 31, 2016).

(\$ thousands)	Total Credit Financing Facilities March 31, 2017	Total Utilized March 31, 2017	Total Available March 31, 2017
Provided by Scotia:			
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 <b>Total</b>	31,000 <b>49,500</b>	<u>-</u> 500	31,000 <b>49,000</b>
Provided by RBC:			
Corporate Credit Card Line*	<u>500</u>	<u>500</u>	<u>=</u>
Total	500	500	-

\*. Included in Accounts payable and accrued expenses

A stand-by fee of 0.10% per annum is applied to the daily unused portion of the Standby Loan and Demand Loan facilities. An annual review fee of 0.05% of the total credit facilities is payable upon confirmation that the Facility has been renewed for a further period, being the earlier of 12 months or the next annual review date.

## 12. Share Based Compensation Plans

#### **Share Options**

The shareholders of the Company approved an Executive Stock Option Plan on October 24, 1991, under which certain employees, officers and directors 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.

Share Options	Number of options	Weighted average exercise price per share	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (\$ millions)
Outstanding at beginning of period	193,500	10.92	-	-
Granted	-	-	-	-
Exercised	(36,400)	9.60	-	0.14
Forfeited/Cancelled	-	-	-	-
Expired	<u>=</u>	Ξ.	=	=
Outstanding, end of period	<u>157,100</u>	<u>11.23</u>	<u>2.58</u>	=
Vested, end of the period	157,100	11.23	2.58	-

Under the fair value method, the compensation expense was \$nil for the three month period ended March 31, 2017 (March 31, 2016: \$0.01 million).

# Performance Share Unit ("PSU") Plan:

In September 2013, the Board of Directors approved a PSU plan under which officers and certain employees of the Company 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.

In September 2013, 21,500 PSUs were granted, with additional grants occurring in March 2014 of 26,000, March 2015 of 27,500, March 2016 of 25,000 and March 2017 of 31,279. 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 three month period ended March 31, 2017, an expense of \$0.1 million was recorded (March 31, 2016: \$0.1 million expense), resulting in a corresponding increase to Other Long-Term Liabilities.

## 13. Earnings per Share

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 32,658,745 and 32,381,631 for the three month periods ended March 31, 2017 and March 31, 2016 respectively.

The weighted average of Class A Ordinary Shares used for determining diluted earnings were 32,675,049 and 32,403,703 for the three month periods ended March 31, 2017 and March

31, 2016 respectively. Diluted earnings per Class A Ordinary Share was calculated using the treasury stock method.

As at March 31, 2017 the outstanding options are not materially dilutive as the market price of common shares is below or marginally higher than the exercise price.

	Earnings (\$ thousands)	Weighted average shares (thousands)	Earnings per common shares March 31, 2017
Net earnings applicable to common shares	4,348		
Weighted Average share outstanding		32,659	
Basic Earnings Per Common Share			0.13
Effect of potential dilutive securities:			
Stock Options	<u>=</u>	<u>16</u>	<u>=</u>
Diluted Earnings per Common Share	4,348	32,675	0.13

	Earnings (\$ thousands)	Weighted average shares (thousands)	Earnings per common shares March 31, 2016
Net earnings applicable to common shares	4,862		
Weighted Average share outstanding		32,382	
Basic Earnings Per Common Share			0.15
Effect of potential dilutive securities:			
Stock Options	<u>=</u>	<u>22</u>	=
Diluted Earnings per Common Share	4,862	32,404	0.15

## 14. 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:

	As at March 31	, 2017	As at December	31, 2016
(\$ thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Long term debt, including current portion	262,687	274,335	222,746	232,369
Fuel Option Contracts <sup>1</sup> 1 Carrying value of fuel option contracts included in Ac	147	147	116	116

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 in 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.

Financial Liability (\$ thousands)	March 31, 2017 Total Fair Value	Level 1 - Quoted Prices in active markets for identical assets	Level 2 - Significant Other inputs	Level 3 - Significant unobservable inputs
Long term debt, including current portion	274,335	-	274,335	-
Fuel Option Contracts <sup>1</sup>	147	-	147	-

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

## 15. 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 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 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.

	Total	2017	2018-	2020-	2022
(\$millions)			2019	2021	Onward
Bank overdraft	-	-	-	-	-
Accounts payable and accrued expenses	26.2	26.2	-	-	-
Consumer's deposits and advances for construction	10.3	10.3	-	-	-
Letter of credit	0.5	0.5	-	-	-
Long term debt	264.0	11.0	29.4	29.0	194.6
Long term debt interest	<u>106.4</u>	<u>12.0</u>	<u>22.5</u>	<u>18.8</u>	<u>53.1</u>
Total	407.4	60.0	51.9	47.8	247.7

#### 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 nil (\$30 million: December 31, 2016).

### 16. Finance Charges

The composition of finance charges were as follows:

(\$ thousands))	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Interest costs - long-term debt	2,821	3,002
Other interest costs	206	53
AFUDC *	<u>(914)</u>	(1,912)
Total	2,113	1,143

<sup>\*</sup>Refer to PP&E with regards to AFUDC (Note 7) methodology.

#### 17. Defined Benefit Pension Plan

The pension costs of the defined benefit plan are actuarially determined using the projected benefits method. Compensation expense of \$0.02 million was recognised for the three months ended March 31, 2017 (\$0.06 million: three months ended March 31, 2016).

The composition of the expense was as follows:

(\$ thousands)	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Interest cost	77	82
	, ,	<u>~ -</u>
Expected return on plan assets	(77)	(77)
Amortisation of actuarial losses	<u>18</u>	<u>56</u>
Total	18	61

This expense has been recorded in general and administrative expenses.

## 18. Foreign Exchange

The closing rate of exchange on March 31, 2017 as reported by the Bank of Canada for the conversion of U.S. dollars into Canadian dollars was Cdn \$1.3310 per US\$1.00. The official exchange rate for the conversion of Cayman Islands dollars into U.S. 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 March 31, 2017 for conversion of Cayman Islands dollars into Canadian dollars was Cdn \$1.5972 per CI\$1.00 (December 31, 2016: Cdn \$1.6112).

## 19. Related Party Transactions

Miscellaneous payables to Fortis Inc., the Company's majority shareholder, was \$11,856 at March 31, 2017 (\$4,485 as at December 31, 2016) for travel expenses, hurricane preparedness, membership fees and insurance premiums. Miscellaneous receivables from Newfoundland Power, a subsidiary of Fortis Inc., was \$10,526 at March 31, 2017 (\$10,526 as at December 31, 2016) for travel expenses. The Company rents office facilities from a related party, Adare Investments Ltd., on a 5 year lease agreement ending June 30, 2019; rent totaled \$22,900 for the three months ended March 31, 2017.

#### 20. 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.

## 21. Commitments

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 - 8.7. 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 – 5.8. Both contracts qualify for the Normal Purchase Normal Sale exemption under ASC 815 and do not qualify as derivatives.

As a result of the Company's bulk fuel inventory, the value of CUC's closing stock of fuel at March 31, 2017 was \$2.7 million (December 31, 2016: \$2.3 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.

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

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

#### **Shareholder Information**

#### **Shareholder Plans**

CUC offers its Shareholders a Dividend Reinvestment Plan. Please contact one of CUC's Registrar and Transfer Agents or write to CUC's Assistant to the Company Secretary if you would like to receive information about the plan or obtain an enrolment form.

CUC also has a Customer Share Purchase Plan for customers resident in Grand Cayman. Please contact our Customer Service Department at (345) 949-5200 if you are interested in receiving details.

#### Shareholder Information

#### **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.

Our Registrar and Transfer Agents are as follows:

#### **CST Trust Company**

P.O. Box 700, Station B Montreal, QC H3B 3K3 North America toll free – 1-800-387-0825 Direct – 416-682-3860

Fax - 1-888-249-6189

E-mail: inquiries@canstockta.com

## Caribbean Utilities Company, Ltd.

Company Secretary P.O. Box 38 Grand Cayman KY1-1101 CAYMAN ISLANDS Tel: (345) 949-5200 Fax: (345) 949-4621

Fax: (345) 949-4621 E-mail: <u>investor@cuc.kv</u>

Website: www.cuc-cayman.com

If you require further information or have any questions regarding CUC's Class A Ordinary Shares (listed in U.S. funds on the Toronto Stock Exchange), please contact:

#### Caribbean Utilities Company, Ltd.

Company Secretary P.O. Box 38 Grand Cayman KY1-1101 CAYMAN ISLANDS Tel: (345) 949-5200

Fax: (345) 949-4621 E-mail: <u>investor@cuc.ky</u> Website: <u>www.cuc-cayman.com</u>