

Caribbean Utilities Company, Ltd.

# **2014 Second Quarter Report** June 30, 2014



#### **About the Company**

Caribbean Utilities Company, Ltd., ("CUC" or "the Company") commenced operations as the only electric utility in Grand Cayman on May 10, 1966.

The Company currently has an installed generating capacity of 131.65 megawatts (MW) and a record peak load of 102.086 MW was experienced on June 3, 2010.

CUC is committed to providing a safe and reliable supply of electricity to over 27,000 customers. The Company has been through many challenging and exciting periods but has kept pace with Grand Cayman's development for over 45 years.

The Company's registered office address is 457 North Sound Road, P.O Box 38, Grand Cayman KY1-1101 and employs 198 employees.

#### **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 two representatives from the Sister Islands of Cayman Brac and Little Cayman.

All dollar amounts in this Quarterly Report are stated in United States dollars unless otherwise indicated.

Readers should review the note, further in this Quarterly Report, in the Management Discussion and Analysis section, concerning the use of forward-looking statements, which applies to the entirety of this Quarterly Report.

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#### Fellow Shareholders,

Caribbean Utilities Company, Ltd. ("CUC" or "the Company") experienced an increase in kilowatt-hour ("kWh") sales and sales revenues when compared to the same period for 2013. Sales for the three months ended June 30, 2014 ("Second Quarter 2014") totalled 144.5 million kWh, an increase of 0.2 million kWh in comparison to 144.3 million kWh for the three months ended June 30, 2013 ("Second Quarter 2013"). Sales for the six months ended June 30, 2014 totalled 275.2 million kWh, an increase of 5.5 million kWh in comparison to 269.7 million kWh for the six months ended June 30, 2013. Sales for the Second Quarter 2014 and the six months ended June 30, 2014 were positively impacted by warmer weather conditions and an increased number of customers when compared to the same periods last year.

Net earnings for the Second Quarter 2014 totalled \$5.7 million, comparable to the net earnings for the Second Quarter 2013. Higher electricity sales revenues in the Second Quarter 2014 were offset primarily by higher consumer service and maintenance costs.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Second Quarter 2014 were \$5.6 million, or \$0.20 per Class A Ordinary Share, comparable to earnings on Class A Ordinary Shares and earnings per Class A Ordinary Share for the Second Quarter 2013.

Net earnings for the six months ended June 30, 2014 totalled \$9.2 million, an increase of \$0.6 million when compared to \$8.6 million for the six months ended June 30, 2013. This increase was due primarily to higher electricity sales revenues and lower depreciation costs. These items were partially offset by higher consumer service and finance charges.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the six months ended June 30, 2014 were \$9.0 million, or \$0.31 per Class A Ordinary Share, an increase of \$0.6 million from the \$8.4 million, or \$0.29 per Class A Ordinary Share for the six months ended June 30, 2013.

During the Second Quarter 2014, there was an increase in the number of customers. Total customers as at June 30, 2014 were 27,462, an increase of 291 customers, or 1%, compared to 27,171 customers as at June 30, 2013.

The 2013 Cayman Islands Annual Economic Report released by the Cayman Islands Government in July 2014 reported that the country's estimated Gross Domestic Product ("GDP") at constant prices rose by 1.2% in 2013. The growth in GDP was attributed to greater economic activity in a number of sectors including hotels and restaurants, transport, storage and communication, and financing and insurance services. As a result, average income (or nominal GDP per capita) in the Cayman Islands rose to \$56,446 in 2013 from \$54,638 in 2012.

The tourism industry is one of the major pillars of the local economy. Air arrivals have a direct impact on the Company's sales growth as these stay-over visitors occupy local accommodation and use the related services. For the Second Quarter 2014 air arrivals were up to 14% when compared to the Second Quarter 2013. Cruise arrivals increased by 22% when compared to the same period in 2013.

The Electricity Regulatory Authority ("ERA") cancelled the previous solicitation process for firm generation in July 2013. This process had been initiated by a Certificate of Need ("CON") issued by CUC in November 2011. The CON was driven primarily by the upcoming retirement of some of the Company's generating units due to begin this year.

Following the issuance of a new CON in October 2013, the ERA has since restarted the process and in May 2014 CUC submitted its bid to the ERA as part of the competitive bid process to secure 36 megawatts ("MW") of new generating capacity required mainly to replace retiring CUC generation. The new capacity is to be operational by May 2016. A decision is expected imminently as the time given by the ERA for the announcement of the winning bidder was late July.

During the Second Quarter 2014 CUC secured the supply of 7.5 MW of temporary mobile generation following the retirement of 17.5 MW of generation. This temporary generation will complement existing generation and help to ensure continuity of supply until the installation of the firm capacity. CUC understands that reliability of service is critical to Grand Cayman's continued growth and development. Our Company continues to focus on maintaining and improving the level of service we offer to our customers.

Capital expenditures totalled \$7.5 million and the Company's reliability of service as measured by the Average Service Availability Index was recorded at 99.96% for the Second Quarter 2014.

During the period under review, an independent, comprehensive, allocated Cost of Service Survey ("COSS") was completed and submitted to the ERA for review. The last COSS conducted by an independent consultant was completed in April 2009.

As a result of the 2014 COSS, the Company adjusted its base rates for a 1% reduction to the residential customer category, a 2.8% increase to the general commercial customer category and a 1.1% increase to the large commercial customer category. Altogether, these adjustments equate to the 1.5% base rate increase allowed under the rate cap and adjustment mechanism ("RCAM").

During the period under review the Company embarked on a number of initiatives, which will continue to enhance the level of service it provides to its customers by offering additional off-site bill payment locations with convenient opening hours, and by improving its Pay-By-Telephone service. More resources were also added to the Company's Customer Contact Centre to improve e-mail and telephone inquiry response times.

The Advanced Metering Infrastructure ("AMI") project is slated for substantial completion by the end of 2014. To date over 8,000 customers have the AMI meters which will assist them with regularly managing their energy usage. The project will also provide real-time consumption information, and bring efficiencies to meter reading as well as other services. AMI will also enable a "Pay-As-You-Go" payment option which will help customers to monitor and control their electricity consumption.

The Company honoured 25 employees for their many years of service, dedication and commitment in April 2014. Collectively, they have given 490 years of service to CUC. We thank them for their steadfast support of and loyalty to the Company over these many years and we applaud the efforts of all employees who continue to embrace the Company's mission "to provide a safe and reliable electricity service at least cost to our customers while delivering a fair return" to you, our shareholders.

J.F. Richard Hew

President & Chief Executive Officer

had burned !

July 29, 2014

#### **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") audited consolidated financial statements and notes thereto for the year ended December 31, 2013. 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 United States Generally Accepted Accounting Principles ("US GAAP"), including certain accounting practices unique to rate-regulated entities. These accounting practices, which are disclosed in the notes to the Company's 2013 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 the recovery or refund would not be subject to regulatory approval.

Certain statements in this MD&A, other than statements of historical fact, are forwardlooking 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 labelled "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. Forwardlooking 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.

#### **Financial and Operational Highlights**

(\$ thousands, except basic earnings per ordinary share, dividends paid per ordinary share and where otherwise indicated)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Change	% Change
Electricity Sales	18,708	18,318	35,613	34,264	1,349	4%
Fuel Factor Revenues	37,863	37,028	74,463	73,607	856	1%
Operating Revenues	56,571	55,346	110,076	107,871	2,205	2%
Fuel and Lube Costs	37,863	37,028	74,463	73,607	856	1%
Other Operating Expenses	11,701	11,202	23,669	23,037	632	3%
Total Operating Expenses	49,564	48,230	98,132	96,644	1,488	2%
Earnings for the Period	5,749	5,716	9,198	8,614	584	7%
Basic Earnings per Class A Ordinary Share	0.20	0.19	0.31	0.29	0.02	7%
Dividends paid per Class A Ordinary Share	0.165	0.165	0.330	0.330	-	0%
Cash Flow from Operating Activities	10,306	10,281	23,994	25,614	(1,620)	-6%
Peak Load Gross (MW)	95.0	94.5	95.0	94.5	0.5	1%
Net Generation (millions of kWh)	154.9	154.6	295.0	289.0	6.0	2%
Kilowatt-Hour Sales (millions of kWh)	144.5	144.3	275.2	269.7	5.5	2%
Total Customers	27,462	27,171	27,462	27,171	291	1%
System Availability (%)	99.96	99.95	99.99	99.96	0.03	0%
Customer per Employee (#)	139	145	139	145	(6)	-4%
Sales per employee (millions of kWh)	0.73	0.77	1.39	1.43	(0.04)	-3%

#### **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 21.5 year non-exclusive Generation Licence ("the Licences") granted by the Cayman Islands Government ("the Government"), which expire in April 2028 and September 2029 respectively.

The Licences contain the provision for a rate cap and adjustment mechanism ("RCAM") based on published consumer price indices. CUC's return on rate base ("RORB") for 2013 was 7.6% (2012: 6.9%). CUC's RORB for 2014 is targeted in the 7.00% to 9.00% range (2013: 6.50% to 8.50%).

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 2014, following review and approval by the Electricity Regulatory Authority ("ERA"), the Company increased its base rates by 1.5%. This increase is a result of the 2013 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 2013. 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 addition to the RORB requirements of the T&D Licence, CUC may periodically (but at least every five years) propose re-balanced and restructured rates, taking into account the results of any cost of service study ("COSS") completed in advance of the proposed rate adjustment. Any such adjustments must be revenue neutral to the base rate adjustment as determined by the RCAM. An independent, comprehensive, allocated COSS was completed and submitted to the ERA for review in April 2014. The last COSS conducted by an independent consultant was completed in April 2009.

An allocated COSS assigns cost responsibility between rate classes based on various relative characteristics – specifically, number of customers, energy sales, impact on peak demands and revenues. For the demand allocation factors, in particular, extensive analysis of customer load data was performed based on interval usage readings collected from CUC's advanced metering infrastructure meters. The sum of all allocated revenue requirements represents the allocated cost of service, or the net revenue requirement for the Base Rates of each of the rate classes.

As a result of the 2014 COSS, the Company adjusted its base rates for a 1% reduction to the residential customer category, a 2.8% increase to the general commercial customer category and a 1.1% increase to the large commercial customer category. The entire exercise must be revenue neutral, that is, the total revenue from all classes must be the same before and after any rebalancing and equivalent to the overall 1.5% base rate increase allowed under the RCAM.

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

The ERA also annually reviews and approves CUC's capital investment plan ("CIP"). \$143.0 million of proposed non-generation installation expenditures in the 2014 to 2018 CIP was approved by the ERA. The remaining \$74.0 million of the CIP relates to new generation installation, which is subject to a competitive bid process and would only be incurred if CUC were the successful bidder.

Following the cancellation by the ERA of the solicitation process that had commenced with the Certificate of Need ("CON") issued by CUC in November 2011, the Company issued a new CON in October 2013 for generation capacity. The CON listed a requirement of 36 megawatts ("MW") of generating capacity, in two 18 MW instalments to be operational April 2016 and May 2016.

In November 2013, the ERA issued a solicitation for Statements of Qualifications from prospective bidders. In January 2014, the ERA announced the parties selected as qualified bidders and released the request for proposal document to all qualified bidders. The Company submitted a bid in May, 2014 and a decision is expected imminently as the time given by the ERA for the announcement of the winning bidder was late July.

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.

CUC's wholly owned subsidiary, DataLink, Ltd. ("DataLink"), has a licence from the Information and Communications Technology Authority ("ICTA") which permits DataLink to provide fibre optic infrastructure and other information and communication technology (ICT) services to the ICT industry. The term of the licence is 15 years and expires on March 27, 2027.

#### **Consolidation Accounting Policy**

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

#### **Earnings**

Net earnings for the three months ended June 30, 2014 ("Second Quarter 2014") totalled \$5.7 million, comparable to net earnings for the three months ended June 30, 2013 ("Second Quarter 2013"). Higher electricity sales revenues were offset primarily by higher consumer service and maintenance costs.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Second Quarter 2014 were \$5.6 million, or \$0.20 per Class A Ordinary Share, comparable to earnings on Class A Ordinary Shares and earnings per Class A Ordinary Share for the Second Quarter 2013.

Net earnings for the six months ended June 30, 2014 totalled \$9.2 million, an increase of \$0.6 million when compared to \$8.6 million for the six months ended June 30, 2013. This increase was due primarily to higher electricity sales revenues and lower depreciation costs. These items were partially offset by higher consumer service and finance charges.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the six months ended June 30, 2014 were \$9.0 million, or \$0.31 per Class A Ordinary Share, an increase of \$0.6 million from the \$8.4 million, or \$0.29 per Class A Ordinary Share for the six months ended June 30, 2013.

#### Sales

Sales for the Second Quarter 2014 totalled 144.5 million kWh, an increase of 0.2 million kWh in comparison to 144.3 million kWh for the Second Quarter 2013. The average monthly

temperature for the Second Quarter 2014 was 83.0 degrees Fahrenheit as compared to average monthly temperature of 82.4 degrees for Second Quarter 2013.

Sales for the six months ended June 30, 2014 totalled 275.2 million kWh, an increase of 5.5 million kWh in comparison to 269.7 million kWh for the six months ended June 30, 2013. Sales for the six months ended June 30, 2014 were positively impacted by warmer weather conditions and an increased number of customers when compared to the same period last year. The average monthly temperature for the first six months of 2014 was 81.5 degrees Fahrenheit as compared to average monthly temperature of 80.9 degrees for the same period last year.

Total customers as at June 30, 2014 were 27,462, an increase of 291 customers, or 1%, compared to 27,171 customers as at June 30, 2013.

The following tables present customer and sales highlights:

Customers (#)		June 3	30, 2014 J	une 30, 2013	Change %
Residential			23,476	23,197	1%
Commercial			<u>3,986</u>	<u>3,974</u>	0%
<b>Total Customers</b>			27,462	27,171	1%
Sales (thousands kWh)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	% Change
Residential	68,155	66,942	128,147	123,703	3.6%
Commercial	74,708	75,666	143,702	142,741	0.7%
Other (street lighting, etc.)	<u>1,686</u>	<u>1,643</u>	<u>3,373</u>	<u>3,262</u>	3.4%
<b>Total Sales</b>	144,549	144,251	275,222	269,706	2.0%

#### **Operating Revenues**

Total operating revenues were as follows:

Revenues (thousands \$)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Change	% Change
Residential	8,984	8,818	17,029	16,311	718	4%
Commercial	9,593	9,385	18,322	17,728	594	3%
Other (street lighting, etc.)	<u>131</u>	<u>115</u>	<u> 262</u>	<u>225</u>	<u>37</u>	16%
<b>Electricity Sales Revenues</b>	18,708	18,318	35,613	34,264	1,349	4%
<b>Fuel Factor Revenues</b>	<u>37,863</u>	<u>37,028</u>	74,463	73,607	<u>856</u>	1%
<b>Total Operating Revenues</b>	56,571	55,346	110,076	107,871	2,205	2%

Operating revenues for the Second Quarter 2014 were \$56.6 million, an increase of \$1.3 million from \$55.3 million for the Second Quarter 2013. Other (street lighting, etc.) revenue for the Second Quarter 2014 totalled \$0.1 million, comparable to the Second Quarter 2013. Other (street lighting, etc.) revenue for the six months ended June 30, 2014 totalled \$0.3 million, an increase of \$0.1 million when compared to \$0.2 million for the six months ended June 30, 2013. This increase is due to an increase in the total number of streetlights.

Electricity sales revenues were \$18.7 million for the Second Quarter 2014, an increase of \$0.4 million from \$18.3 million for the Second Quarter 2013. Electricity sales revenues for the Second Quarter 2014 increased when compared to electricity sales revenue for the Second Quarter 2013 due to higher kWh sales, and 1.8% and 1.5% base rate increases effective June 1, 2013 and June 1, 2014 respectively.

Electricity sales revenues were \$35.6 million for the six months ended June 30, 2014, an increase of \$1.3 million from \$34.3 million for the six months ended June 30, 2013. Electricity sales revenues increased when compared to electricity sales revenue due to a 2% increase in kWh sales period over period, and 1.8% and 1.5% base rate increases effective June 1, 2013 and June 1, 2014 respectively.

Fuel factor revenues for the Second Quarter 2014 totalled \$37.9 million, compared to fuel factor revenues of \$37.0 million for the Second Quarter 2013. Fuel factor revenues for the Second Quarter 2014 increased due to higher kWh sales when compared to the Second Quarter 2013. The average Fuel Cost Charge rate billed to consumers for the three months ended June 30, 2014 was \$0.27 per kWh, compared to the average Fuel Cost Charge rate of \$0.28 per kWh for the three months ended June 30, 2013. CUC passes through all fuel costs to consumers on a two-month lag basis with no mark-up.

Fuel factor revenues for the six months ended June 30, 2014 totalled \$74.5 million, compared to fuel factor revenues of \$73.6 million for the six months ended June 30, 2013. Fuel factor revenues increased due to 2% kWh sales growth experienced period over period. The average Fuel Cost Charge rate billed to consumers for the six months ended June 30, 2014 was \$0.27 per kWh, compared to the average Fuel Cost Charge rate of \$0.28 per kWh for the six months ended June 30, 2013. 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 June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Change	% Change
Power Generation Expenses	38,617	37,749	75,956	75,072	884	1%
General and Administration	2,209	2,239	4,477	4,319	158	4%
Consumer Service	540	412	1,514	821	693	84%
Transmission and Distribution	422	486	919	1,087	(168)	-15%
Depreciation	6,085	6,089	12,198	12,465	(267)	-2%
Maintenance	1,604	1,180	2,897	2,726	171	6%
Amortization of Intangible Assets	<u>87</u>	<u>75</u>	<u>171</u>	<u>154</u>	<u>17</u>	11%
<b>Total Operating Expenses</b>	49,564	48,230	98,132	96,644	1,488	2%

Operating expenses for the Second Quarter 2014 totalled \$49.6 million, a \$1.4 million increase from \$48.2 million for the Second Quarter 2013. This increase was due primarily to higher maintenance and consumer services expenses for the Second Quarter 2014 when compared to the Second Quarter 2013.

Operating expenses for the six months ended June 30, 2014 totalled \$98.1 million, a \$1.5 million increase from \$96.6 million for the six months ended June 30, 2013. This increase was due primarily to higher consumer service, maintenance and general and administration expenses which were partially offset by lower depreciation and transmission and distribution costs.

#### **Power Generation**

Power generation costs for the Second Quarter 2014 increased \$0.9 million to \$38.6 million when compared to \$37.7 for the Second Quarter 2013. This increase is as a result of higher net generation partially offset by lower fuel costs.

Power generation costs for the six months ended June 30, 2014 increased \$0.9 million to \$76.0 million when compared to \$75.1 million for the six months ended June 30, 2013. This increase is as a result of higher net generation partially offset by lower fuel costs.

Power generation expenses were as follows:

Power Generation (\$ thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Change	% Change
Fuel costs (net of deferred fuel charges)	37,239	36,490	73,254	72,494	760	1%
Lubricating Oil costs (net of deferred lubricating oil charges)	624	538	1,209	1,113	96	9%
Other generation expenses	<u>754</u>	<u>721</u>	<u>1,493</u>	<u>1,465</u>	<u>28</u>	2%
Total power generation expenses	38,617	37,749	75,956	75,072	884	1%

The Company's average price per imperial gallon ("IG") of fuel for the Second Quarter 2014 increased 1% to \$4.67, compared to \$4.63 for the Second Quarter 2013. The Company's average price per IG of fuel for the six months ended June 30, 2014 decreased 1% to \$4.71, compared to \$4.76 for the six months ended June 30, 2013.

Net generation was 154.9 million kWh for the Second Quarter 2014 compared to 154.6 million kWh for the Second Quarter 2013. Net generation was 295.0 million kWh for the six months ended June 30, 2014, a 2% increase when compared to 289.0 million kWh for the Second Quarter 2013. Net fuel efficiency for the Second Quarter 2014 of 18.21 kWh per IG decreased when compared to net fuel efficiency for the Second Quarter 2013 of 18.25 kWh per IG. Net fuel efficiency for the six months ended June 30, 2014 of 18.41 kWh per IG decreased when compared to net fuel efficiency for the six months ended June 30, 2013 of 18.47 kWh per IG.

The Company's average price per IG of lubricating oil for the Second Quarter 2014 increased to \$12.46 when compared to \$12.40 for the Second Quarter 2013. The Company's average price per IG of lubricating oil for the six months ended June 30, 2014 declined 3% to \$12.38 when compared to \$12.76 for the six months ended June 30, 2013.

The Fuel Tracker Account (see Note 5 in the Notes to Interim 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 Programme. The objective of the programme is to reduce the impact of volatility in the Fuel Cost Charge paid by the Company's customers for the fuel that the Company must purchase in order to provide electric service. Contracts initiated in March 2014 utilize call spreads to promote transparency

in pricing. The monthly hedging costs and returns are also included within the Fuel Tracker Account.

Other generation expenses for the Second Quarter 2014 totalled \$0.8 million, \$0.1 million increase when compared to other generation expenses of \$0.7 million for the Second Quarter 2013.

Other generation expenses for the six months ended June 30, 2014 totalled \$1.5 million, comparable to other generation expenses for the six months ended June 30, 2013.

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

G&A expenses for the Second Quarter 2014 totalled \$2.2 million, comparable to G&A expenses for the Second Quarter 2013.

General Expenses Capitalised ("GEC") totalled \$0.9 million for the Second Quarter 2014, comparable to GEC for the Second Quarter 2013.

G&A expenses for the six months ended June 30, 2014 totalled \$4.5 million, a \$0.2 million increase compared to \$4.3 million for the six months ended June 30, 2013. This increase was due primarily to the Company's short term incentive plan and the introduction of the Company's Performance Share Unit ("PSU") plan (see Note 12 in the Notes to Consolidated Financial Statements).

General Expenses Capitalised ("GEC") totalled \$1.9 million for the six months ended June 30, 2014, an increase of \$0.1 million compared to \$1.8 million for the six months ended June 30, 2013.

#### Consumer Services ("CS")

CS expenses for the Second Quarter 2014 totalled \$0.5 million, a \$0.1 million increase compared to \$0.4 million for the Second Quarter 2013. This increase is attributable to expenses associated with additional human resources hired in this area to meet the needs of customers.

CS expenses for the six months ended June 30, 2014 totalled \$1.5 million a \$0.7 million increase compared to \$0.8 million for the six months ended June 30, 2013. This increase is attributable to an adjustment to the provision for bad debt and increased expenses associated with additional human resources hired in this area to meet the needs of customers.

In accordance with its Allowance for Doubtful Accounts ("AFDA") policy, the Company maintains an accumulated provision for uncollectible customer accounts receivable that is estimated based on known accounts, historical experience and other currently available information, including the economic environment. During the first six months of 2014, the Company commenced a full review of its outstanding Accounts Receivables balance and the reasonableness of its methodology of applying a flat percentage to total receivables in calculating AFDA. This review has initially indicated an increase in days outstanding for receivable balances and management has determined the estimation process related to the AFDA would be refined to include a risk element for aging of accounts receivable. The effect of this change in estimate was to increase the provision by \$0.5 million.

Trade and other accounts receivables (\$ thousands)	As at June 30, 2014	As at December 31, 2013
Current	11,093	11,914
Past due 31-60 days	1,310	2,018
Past due 61-90 days	633	594
Past due over 90 days	<u>3,835</u>	<u>4,314</u>
<b>Total Accounts Receivables</b>	16,871	18,840
Less: allowance for doubtful accounts	(712)	(195)
Less: Consumer Deposits	(5,290)	(4,998)
Net Exposure	10,869	13,647

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

T&D expenses for the Second Quarter 2014 totalled \$0.4 million, a decrease of \$0.1 million compared to T&D expenses for the Second Quarter 2013 of \$0.5 million. T&D expenses for the Second Quarter 2013 were impacted by maintenance projects that led to higher labour costs than were seen in the Second Quarter 2014.

T&D expenses for the six months ended June 30, 2014 totalled \$0.9 million, a decrease of \$0.2 million compared to T&D expenses for the six months ended June 30, 2013 of \$1.1 million. T&D expenses for the six months ended June 30, 2013 were impacted by maintenance projects that led to higher labour costs than were seen in the six months ended June 30, 2014.

#### Depreciation

Depreciation expenses for the Second Quarter 2014 totalled \$6.1 million, comparable to the Second Quarter 2013.

Depreciation expenses for the six months ended June 30, 2014 totalled \$12.2 million, a decrease of \$0.3 million, from \$12.5 million for the six months ended June 30, 2013. This decrease in depreciation is related to the book retirement of a 7.59 MW generating unit during 2013.

In accordance with its Property, Plant and Equipment ("PP&E") policy, the Company reviews the estimated useful lives of its fixed assets on an ongoing basis. A review concluded during the Second Quarter 2014 indicated that the actual lives of certain Transmission and Distribution ("T&D") and Generation assets were longer than the estimated useful lives used for depreciation purposes in the Company's financial statements. As a result, effective January 1, 2014, the Company changed its estimates of the useful lives of these assets to better reflect the estimated periods during which these assets will remain in service. The affected assets previously averaged useful lives of 20 years which were increased to an average of 25 to 35 years. The effect of this change in estimate was to reduce Second Quarter 2014 depreciation expense by \$0.4 million and depreciation for the six months ended June 30, 2014 by \$0.8 million.

#### **Maintenance**

Maintenance expenses for the Second Quarter 2014 totalled \$1.6 million, an increase of \$0.4 million when compared to \$1.2 million for the Second Quarter 2013. Maintenance expenses for the six months ended June 30, 2014 totalled \$2.9 million, an increase of \$0.2 million when compared to \$2.7 million for the six months ended June 30, 2013.

The increase in maintenance expense for the three and six months ended June 30, 2014 is attributable to ongoing maintenance projects in the generation and information technology areas of the Company. The maintenance to the information technology "("IT") systems has increased

Productivity and efficiencies throughout the organisation. Ongoing maintenance of the generating units is a necessary component of operations.

#### **Amortization**

Amortization of intangible assets for the Second Quarter 2014 totalled \$0.09 million, a 13% increase when compared to \$0.08 million for the Second Quarter 2013. The increase in amortization is attributable to software purchases made in prior periods.

Amortization of intangible assets for the six months ended June 30, 2014 totalled \$0.17 million, a 13% increase when compared to \$0.15 million for the six months ended June 30, 2013. The increase in amortization is attributable to software purchases made in prior periods.

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 ceased 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 Second Quarter 2014 totalled \$1.3 million, a decrease of \$0.1 million from \$1.4 million for the Second Quarter 2013. Net Other Expenses for the six months ended June 30, 2014 totalled \$2.7 million, a decrease of \$0.1 million from \$2.6 million for the six months ended June 30, 2013.

Other Income & Expenses (\$ thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Change	% Change
Total interest costs	(2,975)	(3,055)	(6,005)	(6,087)	82	-1%
AFUDC	629	703	1,172	1,492	(320)	-21%
Total finance charges	(2,346)	(2,352)	(4,833)	(4,595)	(238)	5%
Foreign exchange gain	476	452	969	924	45	5%
Other income	<u>612</u>	<u>500</u>	<u>1,118</u>	1,058	<u>60</u>	6%
<b>Total Net Other Expense</b>	(1,258)	(1,400)	(2,746)	(2,613)	(133)	5%

Finance charges for the Second Quarter 2014 totalled \$2.3 million, a \$0.1 million decrease from \$2.4 million for the Second Quarter 2013. This decrease is as a result of lower interest costs in the Second Quarter 2014.

Finance charges for the six months ended June 30, 2014 totalled \$4.8 million, a \$0.2 million increase from \$4.6 million for the six months ended June 30, 2013. These increases are as a result of lower capitalization of financing costs in 2014.

Under the T&D Licence there is a provision for an Allowance for Funds Used During Construction ("AFUDC"). This capitalisation of the Financing Cost is calculated by multiplying the Company's Cost of Capital rate by the average work in progress for each month. The cost of capital rate for

2014 is 8.0% as agreed with the ERA, in accordance with the T&D Licence, and will be reviewed annually. The cost of capital rate for 2013 was 7.5%.

The AFUDC amount for the Second Quarter 2014 totalled \$0.6 million, a \$0.1 million decrease from \$0.7 million for the Second Quarter 2013. The AFUDC amount for the six months ended June 30, 2014 totalled \$1.2 million, a \$0.3 million decrease from \$1.5 million for the six months ended June 30, 2013. This decrease is attributable to a decreased work in progress value for Second Quarter 2014 when compared to Second Quarter 2013. Work in progress balances will vary depending upon the nature and longevity of projects.

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 Second Quarter 2014 totalled \$0.5 million, comparable to the Second Quarter 2013. Foreign exchange gains for the six months ended June 30, 2014 totalled \$1.0 million, a \$0.1 million increase when compared to \$0.9 million for the six months ended June 30, 2013.

Other income is comprised of income from the Company's wholly-owned subsidiary DataLink, income from pipeline operations, sale of meter sockets, sale of recyclable materials and other miscellaneous income.

Other income totalled \$0.6 million for the Second Quarter 2014, a \$0.1 million increase when compared to other income of \$0.5 million for the Second Quarter 2013. Other income totalled \$1.1 million for the six months ended June 30, 2014, comparable to the six months ended June 30, 2013.

In March 2012, the ERA acknowledged the creation of DataLink Ltd., CUC's wholly owned subsidiary. Subsequently the ICTA granted DataLink a licence to provide fibre optic infrastructure in Grand Cayman. Revenues from DataLink for the Second Quarter 2014 are recorded in Other Income in the amount of \$0.2 million, compared to \$0.1 million for the Second Quarter 2013.

CUC and DataLink have entered into three agreements;

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

All three agreements have been approved by the ERA. The ICT licence allowed DataLink to assume full responsibility for the existing Pole Attachment Agreements and Optical Fibre Lease Agreement with third party information and communications technology service providers. The novation and reassignment of existing contracts was completed in 2012.

#### The Economy

In May 2014, the Cayman Islands Government released the 2014 First Quarter Consumer Price Index ("CPI") Report. The CPI for the three months ended March 31, 2014 increased 2.3% when compared to the same period last year. The CPI for the three months ended March 31, 2014 increased by 0.5% when compared to the three months ended December 31, 2013.

The 2013 Cayman Islands Annual Economic Report released by the Government in July 2014 reported that the country's estimated Gross Domestic Product ("GDP") at constant prices rose by 1.2% in 2013. The growth in GDP was attributed to greater economic activity in a number of sectors including hotels and restaurants, transport, storage and communication, and financing

and insurance services. As a result, average income (or nominal GDP per capita) in the Cayman Islands rose to \$56,446 in 2013 from \$54,638 in 2012.

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

	As at June 2014	As at December 2013	As at December 2012	As at December 2011	As at December 2010
Bank Licences	213	213	222	234	246
Mutual Funds *	11,209	11,379	10,841	9,258	9,438
Mutual Fund Administrators	123	121	124	129	134

• The Cayman Islands Mutual Funds (Amendment) Law, 2011, dated December 22, 2011, amended the Mutual Funds Law (2009 Revision) to require all Master Funds, as defined therein, to become registered by the Cayman Islands Monetary Authority ("CIMA"). Registration for these funds was required for the first time in 2012, previously registration of any such funds was voluntary in nature. As at December 31, 2013 there were 2,635 registered Master Mutual Funds (2012:1,891) and nil as at December 31, 2011 and prior periods.

The other major industry in Cayman is tourism. The tourist demographic is largely comprised of visitors from the US. For the Second Quarter 2014, 78% of air arrivals to the country were citizens of the US. As such the US economy largely impacts that of the Cayman Islands. Second Quarter 2014 air arrivals were up 14% when compared to 2013 and cruise arrivals increased by 22% when compared to 2013. 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 June 30:

Arrivals	2014	2013	2012	2011	2010
By Air	101,085	88,382	84,921	81,224	74,229
By Sea	<u>318,500</u>	<u>260,713</u>	325,843	325,947	<u>394,304</u>
Total	419,585	349,095	410,764	407,171	468,533

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; www.csymanislands.ky; www.caymanfinancialreview.com; www.caymanislands.ky and www.healthcitycaymanislands.com.

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

The following table outlines the summary of cash flows:

Cash Flows (\$ thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Change	% Change
Beginning cash	2,195	2,950	1,215	694	521	75%
Cash provided by/(used in):						
Operating activities	10,306	10,281	23,994	25,614	(1,620)	-6%
Investing activities	(7,184)	(8,094)	(13,739)	(14,496)	757	-5%
Financing activities	(3,303)	(3,773)	(9,456)	(10,448)	992	-9%
Ending cash	2,014	1,364	2,014	1,364	650	48%

#### Operating Activities:

Cash flow provided by operations, after working capital adjustments, for the Second Quarter 2014, was \$10.3 million, comparable to the Second Quarter 2013.

Cash flow provided by operations, after working capital adjustments, for the six months ended June 30, 2014, was \$24.0 million, a decrease of \$1.6 million from \$25.6 million for the six months ended June 30, 2013. This decrease is mainly attributable to the movement in regulatory deferrals in the six months ended June 30, 2014 when compared to the same period last year.

#### Investing Activities:

Cash used in investing activities for the Second Quarter 2014 totalled \$7.2 million, a decrease of \$0.9 million from \$8.1 million for the Second Quarter 2013. This decrease is mainly attributable to lower expenditures related to property, plant and equipment for the period.

Cash used in investing activities for the six months ended June 30, 2014 totalled \$13.7 million, a decrease of \$0.8 million from \$14.5 million for the six months ended June 30, 2013. This decrease is mainly attributable to lower expenditures related to property, plant and equipment for the period.

#### Financing Activities:

Cash used in financing activities for the Second Quarter 2014 totalled \$3.3 million, a decrease of \$0.5 million compared to cash used in financing activities of \$3.8 million for the Second Quarter 2013. This decrease in cash used in financing activities is attributable to lower overdraft repayments in the Second Quarter 2014.

Cash used in financing activities for the six months ended June 30, 2014 totalled \$9.5 million, a decrease of \$0.9 million compared to cash used in financing activities of \$10.4 million for the six months ended June 30, 2013. This decrease in cash used in financing activities is attributable to lower overdraft repayments in the six months ended June 30, 2014.

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

Miscellaneous payables to Fortis Turks & Caicos, also a subsidiary of Fortis Inc., were \$1.1 thousand at June 30, 2014 (nil as at December 31, 2013) for travel expenses. Miscellaneous payables to Fortis Inc., the Company's majority shareholder, totalling \$28.4 thousand were outstanding at June 30, 2014 (\$9.8 thousand as at December 31, 2013) for labour, hurricane preparedness and travel expenses and are included within the Accounts Payable and Accrued Expenses on the Balance Sheet. Miscellaneous receivables from Fortis Inc. were \$11.2 thousand at June 30, 2014 (nil as at December 31, 2013) for travel expenses.

### **Contractual Obligations**

The contractual obligations of the Company over the next five years and periods thereafter, as at June 30, 2014, are outlined in the following table:

(\$ millions)	Total	< 1 year	1 to 3 years	4 to 5 years	> 5 years
Total debt	220.0	29.0	25.0	29.4	136.6
Defined benefit pension	0.1	0.1	-	-	-
Total	220.1	29.1	25.0	29.4	136.6

The Company executed a primary fuel supply contract with Rubis Cayman Islands Limited ("Rubis") in September 2012 upon the expiration of its previous fuel supply contracts. Under the agreement, the Company is committed to purchase approximately 60% of its diesel fuel requirements for its generating plant from Rubis. The approximate quantities per the contract on an annual basis are, by fiscal year in millions of IGs: 2014 – 11.3.

The Company also has a secondary fuel supply contract with Sol Petroleum Cayman Limited ("Sol") (previously Esso Cayman Limited) executed in September 2012 and is committed to purchase approximately 40% of the Company's diesel fuel requirements for its generating plant from Sol. Both contracts expire July 2014 with the option to renew for two additional 18 month terms. Renewal cannot occur more than six months in advance of the current contract expiry date.

#### **Financial Position**

The following table is a summary of significant changes to the Company's balance sheet from December 31, 2013 to June 30, 2014:

Significant changes in Balance Sheets between December 31, 2013 and June 30, 2014	Increase (Decrease)	Explanation
(\$ millions)		
Cash and Cash Equivalents	0.8	Increase due to cash provided by operating activities of \$24.0 million offset by cash used in financing activities of \$9.5 million and by cash used in investing activities of \$13.7 million.
Accounts Receivable	(2.5)	Increased collections and increased allowance for doubtful accounts.
Regulatory Assets	3.9	In accordance with regulatory treatment the fuel tracker account is classified as a regulatory asset. This amount represents fuel costs incurred by the Company that are recoverable from the customer.
Prepayments	(1.8)	Decrease due to recognition of the expense associated with the Company's property and machinery breakdown insurance policy.
Property, Plant and Equipment	1.6	Net increase is comprised of (1) capital expenditures of \$14.0 million (2) depreciation expense of \$12.2 million (3) \$0.2 million in accrued capital expenditure.
Bank Overdraft	(1.1)	Decrease in bank overdraft.
Accounts Payable and Accrued Expenses	1.2	Increased payable related to fuel costs Fuel consumption increases in the summer months leading to higher payable balances.
Short-Term Debt	15.0	Increase due to drawdown on RBC capital expenditure credit facility in May 2014.
Current Portion of Long-Term Debt	(3.0)	Decrease due to full repayment of Company's 7.64% Senior Unsecured Note Loan Note in June 2014.
Long-Term Debt	(11.0)	Decrease due to principle payments made on the Company's Senior Unsecured Notes in the Second Quarter 2014.
Share Premium	1.0	The Company issued 98,161 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 rights offering that occurred in 2008 and through 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 65% of the Company's consolidated capital structure, as defined by the long-term debt agreements. As at June 30, 2014, the Company was in compliance with all debt covenants.

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

Capital structure	<b>June 30, 2014</b> (\$ millions)	%	December 31, 2013 (\$ millions)	%
Total debt	220.0	55	219.0	55
Shareholder's equity	<u>178.7</u>	<u>45</u>	<u>178.3</u>	<u>45</u>
Total	398.7	100	397.3	100

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

S&P A-/Negative 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.

Following Fortis Inc.'s December 2013 announcement of a proposed \$4.3 billion acquisition of UNS Energy Corp., an Arizona-based holding company that wholly owns Tucson Electric Power Co. (TEP), S&P affirmed the Company's A- rating and revised its outlook on the Company from Stable to Negative.

The negative outlook on CUC reflects the application of S&P's group rating methodology and an expectation that Fortis Inc.'s credit metrics would materially weaken due to convertible debentures used to finance the acquisition. The S&P report also indicates their belief that there are insufficient ring-fencing mechanisms between Fortis and its subsidiaries, including CUC, to allow for further rating separation.

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 February 2014, 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 small size of customer base.

#### 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 allowances in the Licences for review of the RCAM by the ERA in order to enable the Company to maintain sound credit ratings.

#### **Credit Facilities**

The Company currently has \$47.0 million of unsecured credit financing facilities with the Royal Bank of Canada ("RBC"). The financing facilities are comprised of:

Credit Facilities	(\$ millions)
Corporate Credit Card Line	\$0.5
Letters of Credit	\$0.5
Operating, Revolving Line of Credit	\$7.5
Catastrophe Standby Loan	\$7.5
Demand Loan Facility- Interim Funding of Capital Expenditures	<u>\$31.0</u>
Total	\$47.0

Of the total above, \$30.8 million was available at June 30, 2014.

#### **Capital Expenditures**

Capital expenditures for the three months ended June 30, 2014 were \$7.5 million, a \$0.6 million, or 7% decrease from \$8.1 million in capital expenditures for the three months ended June 30, 2013.

Capital expenditures for the six months ended June 30, 2014 were \$14.0 million, a \$0.5 million, or 3% decrease from \$14.5 million in capital expenditures for the six months ended June 30, 2013. The capital expenditures for the six months ended June 30, 2014 primarily relate to:

- Distribution system extension and upgrades \$5.9 million.
- Generation Replacement Cost \$6.3 million.
- AFUDC of \$1.2 million was capitalized in the six months ended June 30, 2014

Capital Expenditure	Three Months Ended June 30,	Three Months Ended June	Six Months Ended June	Six Months Ended June
(\$ Millions)	2014	30, 2013	30, 2014	30, 2013
Transmission & Distribution	3.2	2.8	6.3	6.1
Generation	3.6	5.2	6.8	8.1
Other	<u>0.7</u>	0.1	0.9	0.3
Total	7.5	8.1	14.0	14.5

#### **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 June 30, 2014.

#### **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 factors. 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 safe and efficient 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 programs 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 program that provides coverage for business interruption, liability and property damage, although the coverage offered by this program is limited (see the "Insurance" section for discussion of insurance terms and coverage). In the event of a large uninsurable loss, the Company would apply to the ERA for recovery of these costs through higher rates. However, there is no assurance that the ERA will approve any such application (see the "Regulation" section for discussion of regulatory risk).

#### Economic Conditions

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

#### Regulation

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

#### 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 proper 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, land use activities, and the handling, storage, processing, use, emission and disposal of materials and waste products.

In 2004, CUC was initially registered to the ISO 14001:2007 which is the international standard for Environmental Management Systems ("EMS"). Under the ISO 14001 standard CUC is required to adhere to all applicable local legislation to prevent pollution to the environment as well as any self-determined procedures, practices, and policies. The Company continuously adheres with the standard, and recertification must occur every three years. The Company has most recently received a recertification audit in March 2013, and zero non-conformances were identified, allowing CUC to be eligible for recertification.

In March 2007, the Kyoto Protocol was signed by the Cayman Islands; this framework aims to reduce Greenhouse Gas ("GHG") emissions produced by certain industries. 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 Government to quantify as best as possible the country's fuel consumption across a variety of sectors, production processes and distribution means. CUC has been in full cooperation with the Cayman Islands Government with supplying information requested for our industry to address this inventory.

Through adhering to local environmental legislation, cooperating with the Cayman Islands government departments and authorities, and by registering our EMS with an international standard CUC has determined that its exposure to environmental risks is not significant and does not have an impact on 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, 2014 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 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 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 rate regulated accounting and differs from the GAAP 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. 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. There is no assurance that the pension plan assets will be able to earn the assumed rate of returns. The assumed long-term rate of return on pension plan assets, for the purposes of estimating pension expense for 2014 is 5%. This compares to assumed long-term rates of return of 5% used during 2013. The gain on pension plan assets during 2013 was 7% (2012: gain of 9%).

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 2014 is 4.9% compared to the discount rate assumed during 2013 which was 3.7%.

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.

#### CHANGES IN ACCOUNTING ESTIMATES

Property, Plant and Equipment ("PP&E")

In accordance with its PP&E policy, the Company reviews the estimated useful lives of its fixed assets on an ongoing basis. A review concluded during the first three months of 2014 indicated that the actual lives of certain T&D and Generation assets were longer than the estimated useful lives used for depreciation purposes in the Company's financial statements. As a result, effective January 1, 2014, the Company changed its estimates of the useful lives of these assets to better reflect the estimated periods during which these assets will remain in service. The affected assets previously averaged useful lives of 20 years which were increased to an average of 25 to 35 years.

The effect of this change in estimate for the Second quarter 2014 was to reduce the depreciation expense by \$0.4 million, increase net earnings by \$0.4 million, and increase basic and diluted earnings per share by \$0.01. The effect of this change in estimate for the six months ended June 30, 2014 was to reduce the depreciation expense by \$0.8 million, increase net earnings by \$0.8 million, and increase basic and diluted earnings per share by \$0.02.

#### Allowance for Doubtful Accounts ("AFDA")

In accordance with its AFDA policy, the Company maintains an accumulated provision for uncollectible customer accounts receivable that is estimated based on known accounts, historical experience and other currently available information, including the economic environment. During the First Quarter 2014, the Company commenced a full review of its outstanding Accounts Receivables balance and the reasonableness of its methodology of applying a flat percentage to total receivables in calculating AFDA. This review has initially indicated an

increase in days outstanding for receivable balances and management has determined the estimation process related to the AFDA would be refined to include a risk element for aging of accounts receivable.

There was no effect from this change of estimate on the Second Quarter 2014. The effect of this change in estimate for the six months ended June 30, 2014 was to increase the provision by \$0.5 million, decrease net earnings by \$0.5 million, and decrease basic and diluted earnings per share by \$0.02.

#### **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 June 30, 2014, the amount of unbilled revenue recorded in Electricity Sales was \$3.5 million (June 30, 2013: \$4.2 million).

#### Kilowatt-Hour ("kWh") Sales

Kilowatt-hour sales throughout the month are based on meter readings that establish electricity consumption since the last meter reading. The kWh accrual for the period is based on estimated electricity sales to customers since the last meter reading. The estimation process for electricity consumption will result in adjustments of kWh sales statistics in the periods they become known when actual results differ from the estimates. As at June 30, 2014, the amount of estimated kWh sales was 25.8 million kWh (June 30, 2013: 30.6 million kWh).

#### Employee Future Benefits

The Company's defined benefit pension plan is subject to judgments utilised in the actuarial determination of the expense and related obligation. There are currently two participants in the

Company's defined benefit pension plan. The main assumptions utilised 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 June 30, 2014, the Company has a long-term liability of \$0.3 million (December 31, 2013: \$0.3 million).

#### Property, Plant and Equipment Depreciation

Depreciation, by its very nature is an estimate based primarily on the estimated useful life of the asset. Estimated useful lives are based on current facts and historical information and take into consideration the anticipated physical life of the assets. As at June 30, 2014, the net book value of the Company's PP&E was \$381.0 million compared to \$379.3 million as at December 31, 2013, increasing as a result of the Company's generation and T&D capital expenditures. Depreciation expense for the Second Quarter 2014 was \$6.1 million (\$6.1 million for the Second Quarter 2013). Due to the value of the Company's PP&E, 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 September 30, 2012 through June 30, 2014. 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
June 30, 2014	56,571	5,749	5,636	0.20	0.20
March 31, 2014	53,505	3,448	3,335	0.11	0.11
December 31, 2013	58,801	5,760	5,169	0.18	0.18
September 30, 2013	59,547	6,048	5,935	0.21	0.21
June 30, 2013	55,346	5,716	5,603	0.19	0.19
March 31, 2013	52,525	2,898	2,785	0.10	0.10
December 31, 2012	59,087	4,061	3,468	0.12	0.12
September 30, 2012	58,870	6,582	6,469	0.22	0.22

#### June 2014/June 2013

Net earnings for the three months ended June 30, 2014 ("Second Quarter 2014") totalled \$5.7 million, comparable to net earnings for the three months ended June 30, 2013 ("Second Quarter 2013"). Higher electricity sales revenues were offset primarily by higher consumer service and maintenance costs.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Second Quarter 2014 were \$5.6 million, or \$0.20 per Class A Ordinary Share, comparable to earnings on Class A Ordinary Shares and earnings per Class A Ordinary Share for the Second Quarter 2013.

#### March 2014/March 2013

Net earnings for the three months ended March 31, 2014 ("Second Quarter 2014") totalled \$3.4 million, an increase of \$0.5 million when compared to \$2.9 million for the three months ended March 31, 2013 ("Second Quarter 2013"). This increase was due primarily to higher electricity sales revenues and lower depreciation costs. These items were partially offset by higher consumer service costs and finance charges.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Second Quarter 2014 were \$3.3 million, or \$0.11 per Class A Ordinary Share, an increase of \$0.5 million from the \$2.8 million, or \$0.10 per Class A Ordinary Share for the Second Quarter 2013.

#### December 2013/December 2012

Net earnings for the three months ended December 31, 2013 ("Fourth Quarter 2013") were \$5.8 million, a \$1.7 million increase when compared to \$4.1 million for the three months ended December 31, 2012 ("Fourth Quarter 2012"). This increase is attributable to a 6% increase in kWh sales, higher other income and lower non-fuel operating expenditure. These items were partially offset by higher finance charges and lower foreign exchange gains for the Fourth Ouarter 2013 when compared to the Fourth Ouarter 2012.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Fourth Quarter 2013 were \$5.2 million, or \$0.18 per Class A Ordinary Share, as compared to \$3.5 million, or \$0.12 per Class A Ordinary Share for the Fourth Quarter 2012.

#### September 2013/September 2012

Net earnings for the three months ended September 30, 2013 ("Third Quarter 2013") totalled \$6.0 million, a decrease of \$0.6 million when compared to \$6.6 million for the three months ended September 30, 2012 ("Third Quarter 2012"). This decrease was due primarily to higher depreciation and finance charges, while electricity sales revenues were flat. These items were partially offset by lower general and administration and maintenance costs. Maintenance costs declined as a result of the Company's focus in 2013 on capital-related upgrade projects that improve the efficiency of its generating units.

After the adjustment for dividends on the preference shares of the Company, earnings on Class A Ordinary Shares for the Third Quarter 2013 were \$5.9 million, or \$0.21 per Class A Ordinary Share, a decrease of \$0.6 million from the \$6.5 million, or \$0.22 per Class A Ordinary Share for the Third Quarter 2012.

#### **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, to provide reasonable assurance that material information relating to the Company is made known to them by others, particularly during the quarter ending June 30, 2014 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.

#### 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 original Internal Control-Integrated Framework by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

There was no material weakness relating to design existing as of June 30, 2014. There has been no change in the Company's ICFR that occurred during the period beginning on January 1, 2014 and ended on June 30, 2014 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

#### **Outlook**

In October 2013 the Company issued a Certificate of Need ("CON") for generation capacity driven primarily by the upcoming retirements of some of the Company's generating units due to begin in 2014. The CON listed a requirement of 36 MW of generating capacity, with 18 MW to be operational no later than April 2016 and the remaining 18 MW to be operational no later than May 2016.

The ERA issued a solicitation for Statements of Qualifications from prospective bidders in November 2013. The deadline for submissions was December 20, 2013. In January 2014 the ERA announced the listing of qualified bidders and issued a request for proposals. Bids were submitted in May 2014. A decision is expected imminently as the time given by the ERA for the announcement of the winning bidder was late July.

#### **Outstanding Share Data**

At June 30, 2014 the Company had issued and outstanding 29,157,923 Ordinary Shares and 250,000 9% cumulative Participating Class B Preference Shares.

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

Letitia T. Lawrence

Vice President Finance & Chief Financial Officer

July 29, 2014

### Consolidated Balance Sheets (expressed in thousands of United States Dollars)

Unaudited	Note	As at June 30, 2014	As at December 31, 2013
Assets			
Current Assets			
Cash and Cash Equivalents		2,014	1,215
Accounts Receivable	4	16,159	18,645
Related Party Receivables	21	11	-
Regulatory Assets	5	28,294	24,373
Inventories	6	5,047	5,185
Prepayments		<u>877</u>	<u>2,703</u>
		52,402	52,121
Property, Plant and Equipment	7	380,960	379,329
Other Assets	8	1,421	1,509
Intangible Assets	9	<u>2,817</u>	<u>2,791</u>
Total Assets		437,600	435,750
Liabilities and Shareholders' Equity			
Current Liabilities			
Bank Overdraft		169	1,258
Accounts Payable and Accrued Expenses	10	32,835	31,633
Related Party Payables	21	29	10
Regulatory Liabilities	5	194	242
Short-Term Debt	11	15,000	-
Current Portion of Long-Term Debt		14,000	17,000
Consumers' Deposits and Advances for Construction	on	<u>5,290</u> 67,517	<u>4,998</u> 55,141
Defined Benefit Pension Liability	17	286	283
Long-Term Debt	14	191,000	202,000
Other Long term Liabilities	12		
Total Liabilities	12	121 258,924	34 257,458
Shareholders' Equity			
Share Capital		1,986	1,980
Share Premium		81,973	81,023
Additional Paid in Capital	12	493	479
Retained Earnings		94,438	95,064
Accumulated Other Comprehensive Loss		(214)	(254)
Total Shareholders' Equity		178,676	178,292
Total Liabilities and Shareholders' Equity		437,600	435,750

#### **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 June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Operating Revenues					
Electricity Sales		18,708	18,318	35,613	34,264
Fuel Factor		37,863	37,028	74,463	73,607
Total Operating Revenues		56,571	55,346	110,076	107,871
Operating Expenses		/-	)-	-,-	- ,-
Power Generation		38,617	37,749	75,956	75,072
General and Administration		2,209	2,239	4,477	4,319
Consumer Services		540	412	1,514	821
Transmission and Distribution		422	486	919	1,087
Depreciation		6,085	6,089	12,198	12,465
Maintenance		1,604	1,180	2,897	2,726
Amortization of Intangible Assets		<u>87</u>	<u>75</u>	<u>171</u>	<u>154</u>
Total Operating Expenses		49,564	48,230	98,132	96,644
Operating Income		7,007	7,116	11,944	11,227
Other (Expenses)/Income:					
Finance Charges	16	(2,346)	(2,352)	(4,833)	(4,595)
Foreign Exchange Gain	18	476	452	969	924
Other Income		<u>612</u>	<u>500</u>	<u>1,118</u>	1,058
Total Net Other (Expenses)/Income		(1,258)	(1,400)	(2,746)	(2,613)
Earnings for the Period		5,749	5,716	9,198	8,614
Preference Dividends Paid- Class B		(113)	(113)	(226)	(226)
Earnings on Class A Ordinary Shares		5,636	5,603	8,972	8,388
Weighted-Average Number of Class A Ordinary Shares Issued and Fully Paid (in thousands)	13	29,106	28,857	29,121	28,878
Earnings per Class A Ordinary Share	13	0.20	0.19	0.31	0.29
Diluted Earnings per Class A Ordinary Share	13	0.20	0.19	0.31	0.29
Dividends Declared per Class A Ordinary Share	13	0.165	0.19	0.330	0.29
Dividends Decialed per Class A Ordinary Share		0.103	0.103	0.550	0.550

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

Unaudited	Three Months Ended June 30,	Three Months Ended June 30,	Six Months Ended June 30,	Six Months Ended June 30,
Not Fourings for the Poriod	2014	2013	9,198	2013 8,614
Net Earnings for the Period	5,749	5,716	9,196	0,014
Other Comprehensive Income/(Loss):				
Amounts arising during the period				
Defined Benefit Pension plans:				
Net actuarial (loss)/gain	-	-	-	-
Reclassification to net income				
Defined Benefit Pension plans:				
Amortization of prior service costs	20	62	40	124
Amortization of net actuarial loss	Ξ	<u>33</u>	<u>=</u>	<u>67</u>
Total Other Comprehensive Income	20	95	40	191
Comprehensive Income	5,769	5,811	9,238	8,805

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

	Class A Ordinary Shares (in thousands)	Common Shares Value (\$)	Preference Shares (\$)	Share premium (\$)	Additional paid-in capital (\$)	Accumulated Other Comprehensive Loss (\$)	Retained Earnings (\$)	Total Equity (\$)
As At January 1, 2014	29,060	1,730	250	81,023	479	(254)	95,064	178,292
Net Earnings Common Share Issuance & stock							9,198	9,198
options plans Defined benefit plans	98	6		950	14	40		970
Dividends on common shares Dividends on			-			-	(9,598)	(9,598)
preference shares As At June 30, 2014	29,158	1,736	250	81,973	493	(214)	(226) 94,438	(226) 178,676
As At January 1, 2013	28,806	1,715	250	78,524	450	(1,720)	94,647	173,866
Net Earnings Common Share Issuance & stock	-	-	-	- 10,324	-	(1,720)	8,614	8,614
options plans Defined benefit plans	118	7		1,141	14	191		1,162
Dividends on common shares Dividends on		-		-		-	(9,516)	(9,516)
preference shares As At June 30, 2013	28,924	1,722	250	79,665	464	(1,529)	(226) 93,519	(226) 174,091

#### **Consolidated Statements of Cash Flows**

(expressed in thousands of United States Dollars)

Unaudited	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Operating Activities				
Earnings for the period	5,749	5,716	9,198	8,614
Items not affecting cash:				
Depreciation	6,085	6,089	12,198	12,465
Amortization of Intangible Assets	87	75	171	154
Non-cash Pension Expenses	22	87	44	-
Amortization of Deferred Financing Costs	42	49	86	98
Stock-based compensation	<u>7</u>	<u>7</u>	<u>14</u>	<u>14</u>
	11,992	12,023	21,711	21,345
Net change in non-cash working capital balances				
related to operations	(11)	(742)	6,252	6,478
Net Change in Regulatory Deferrals	(1,675)	(1,000)	(3,969)	(2,209)
Cash flow related to operating activities	10,306	10,281	23,994	25,614
Investing Activities				
Purchase of property, plant and equipment	(7,490)	(8,095)	(14,001)	(14,494)
Costs related to intangible assets	(17)	(3)	(70)	(21)
Contributions in Aid of Construction	320	-	320	-
Proceeds on sale of property, plant and equipment	<u>3</u>	<u>4</u>	<u>12</u>	<u>19</u>
Cash flow related to investing activities	(7,184)	(8,094)	(13,739)	(14,496)
Financing Activities				
Proceeds from debt financing	15,000	50,000	15,000	50,000
Repayment of debt	(14,000)	(47,500)	(14,000)	(47,500)
Increase in bank overdraft	169	(1,727)	(1,089)	(3,549)
Dividends paid	(4,936)	(5,200)	(10,323)	(10,545)
Net proceeds from share issues	<u>464</u>	<u>654</u>	<u>956</u>	<u>1,146</u>
Cash flow related to financing activities	(3,303)	(3,773)	(9,456)	(10,448)
(Decrease)/Increase in net cash and cash equivalents	(181)	(1,586)	799	670
Cash and cash equivalents - Beginning of period	2,195	2,950	<u>1,215</u>	<u>694</u>
Cash and cash equivalents - End of period	2,014	1,364	2,014	1,364
Supplemental disclosure of cash flow information: Interest paid during the period	5,976	5,785	5,990	5,933

#### **Notes to Interim Consolidated Financial Statements**

Unaudited - June 30, 2014 (expressed in thousands of United States dollars unless otherwise stated)

#### 1. Nature of Operations and Consolidated Financial Statement Presentation

These consolidated financial statements have been prepared in accordance with United States Generally Accepted Accounting Principles ("US GAAP") and reflect the decisions of the Electricity Regulatory Authority ("ERA"). 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 consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary DataLink, Ltd. ("DataLink").

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 21.5 year non-exclusive Generation Licence (collectively the "Licences") with the Cayman Islands Government ("the Government"), which expire in April 2028 and September 2029 respectively. These consolidated interim financial statements do not include all of the disclosures normally found in the Company's annual financial statements and should be read in conjunction with the MD&A and audited financial statements and notes thereto for the year ended December 31, 2013, with 2012 comparatives, prepared in accordance with US GAAP included in the Company's 2013 Annual Report.

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

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

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

#### Rate Regulated Operations

CUC's base rates are designed to recover all non-fuel and non-regulatory costs and include per kilowatt-hour ("kWh") electricity charges and fixed facilities charges. Fuel cost charges and regulatory fees are billed as separate line items. Base rates are subject to an annual review and adjustment each June through the RCAM. In June 2014, following review and approval by the Electricity Regulatory Authority ("ERA"), the Company increased its base rates by 1.5%. This increase is a result of the 2013 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 2013. All fuel and lubricating oil costs are passed through to customers without mark-up as a per kWh charge.

For regulatory purposes fixed assets comprise the completed Property, Plant and Equipment ("PP&E") and intangible assets acquired or constructed by the Company as reported in the Company's consolidated financial statements. The original book value of these fixed assets include an Allowance for Funds Used During Construction ("AFUDC") (Note 7) and an allowance for General Expenses Capitalised ("GEC") (Note 7). 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. Changes in Accounting Estimates

Property, Plant and Equipment

In accordance with its PP&E policy, the Company reviews the estimated useful lives of its fixed assets on an ongoing basis. A review concluded during the first three months of 2014 indicated that the actual lives of certain T&D and Generation assets were longer than the estimated useful lives used for depreciation purposes in the Company's financial statements. As a result, effective January 1, 2014, the Company changed its estimates of the useful lives of these assets to better reflect the estimated periods during which these assets will remain in service. The affected assets previously averaged useful lives of 20 years which were increased to an average of 25 to 35 years.

The effect of this change in estimate for the second quarter 2014 was to reduce the depreciation expense by \$0.4 million, increase net earnings by \$0.4 million, and increase basic and diluted earnings per share by \$0.01. The effect of this change in estimate for the six months ended June 30, 2014 was to reduce the depreciation expense by \$0.8 million, increase net earnings by \$0.8 million, and increase basic and diluted earnings per share by \$0.02.

#### Allowance for Doubtful Accounts ("AFDA")

In accordance with its AFDA policy, the Company maintains an accumulated provision for uncollectible customer accounts receivable that is estimated based on known accounts, historical experience and other currently available information, including the economic environment. During the First Quarter 2014, the Company commenced a full review of its outstanding Accounts Receivables balance and the reasonableness of its methodology of applying a flat percentage to total receivables in calculating AFDA. This review has initially indicated an increase in days outstanding for receivable balances and management has determined the estimation process related to the AFDA would be refined to include a risk element for aging of accounts receivable.

There was no effect of this change in estimate on the Second Quarter 2014. The effect of this change in estimate for the six months ended June 30, 2014 was to increase the provision by \$0.5 million, decrease net earnings by \$0.5 million, and decrease basic and diluted earnings per share by \$0.02.

# 4. Accounts Receivable

	As at June 30, 2014	As at December 31, 2013
Billings to consumers	11,968	12,979
Unbilled revenues	3,455	3,661
Other receivables	1,448	2,200
Allowance for doubtful accounts	<u>(712)</u>	(195)
Total Accounts Receivable	16,159	18,645

#### 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 June 30, 2014 also include billing adjustments for commercial customers.

# 5. Regulatory Assets and Liabilities

Asset/Liability	Description	As at June 30, 2014	As at December 31, 2013
Regulatory Assets	Fuel Tracker Account (a)	26,213	22,867
Regulatory Assets	Derivative contract (b)	427	-
Regulatory Assets	Miscellaneous Regulatory Assets (c)	313	329
Regulatory Assets	Government & Regulatory Tracker Account (d)	<u>1,341</u>	<u>1,177</u>
<b>Total Regulatory Assets</b>		28,294	24,373
Regulatory Liabilities	Miscellaneous Regulatory Liabilities (e)	(194)	(242)
<b>Total Regulatory Liabilities</b>		<u>(194)</u>	(242)

- 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 May 2015.
- c) Miscellaneous regulatory assets represent costs incurred by the Company, other than fuel and the specifically itemised licence and regulatory fees, to be recovered through the Company's base rates on terms as agreed with the ERA.
- d) Government and Regulatory Tracker Account A licence fee of 1% of gross revenues applies to customer billings for consumption over 1,000 kWh per month as a pass-through charge on a per kWh basis. Additionally, a regulatory fee of ½ of 1% is charged on gross revenues then prorated and applied only to customer billings with consumption over 1,000 kWh per month. The government and regulatory tracker account is the actual fee incurred less the amount of funds received from consumers.
- e) Miscellaneous regulatory liabilities represent costs owed by the Company, other than licence and regulatory fees, to be recovered through the Company's base rates on terms as agreed with the ERA.

# 6. Inventories

The composition of inventories is shown in the table below:

Inventories	As at June 30, 2014	As at December 31, 2013
Fuel	4,209	4,591
Lubricating Oil	753	499
Line spares	76	79
Other	<u>9</u>	<u>16</u>
Total	5,047	5,185

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

Property, Plant and Equipment	Cost	Accumulated Depreciation	Net Book Value June 30, 2014
Transmission & Distribution (T&D)	290,105	99,304	190,801
Generation	297,857	129,930	167,927
Other:			
Land	5,304	-	5304
Buildings	19,966	10,328	9,638
Equipment, motor vehicles and			
computers	<u>21,759</u>	<u>15,088</u>	<u>6,671</u>
Total	634,991	254,650	380,341
Datalink, Ltd.	<u>619</u>	Ξ.	<u>619</u>
Property, plant and equipment	635,610	<u>254,650</u>	380,960
		Accumulated	Net Book Value
Property, Plant and Equipment	Cost	Accumulated Depreciation	Net Book Value December 31, 2013
Property, Plant and Equipment Transmission & Distribution (T&D)	<b>Cost</b> 283,944		
		Depreciation	<b>December 31, 2013</b>
Transmission & Distribution (T&D)	283,944	Depreciation 95,368	December 31, 2013 188,576
Transmission & Distribution (T&D) Generation	283,944	Depreciation 95,368	December 31, 2013 188,576
Transmission & Distribution (T&D) Generation Other:	283,944 291,459	Depreciation 95,368	December 31, 2013 188,576 168,576
Transmission & Distribution (T&D) Generation Other: Land	283,944 291,459 5,304	Depreciation 95,368 122,883	December 31, 2013 188,576 168,576 5,304
Transmission & Distribution (T&D) Generation Other: Land Buildings Equipment, motor vehicles and computers	283,944 291,459 5,304 19,993 21,244	Depreciation 95,368 122,883 - 10,068	December 31, 2013 188,576 168,576 5,304
Transmission & Distribution (T&D) Generation Other: Land Buildings Equipment, motor vehicles and	283,944 291,459 5,304 19,993	Depreciation 95,368 122,883	December 31, 2013 188,576 168,576 5,304 9,925
Transmission & Distribution (T&D) Generation Other: Land Buildings Equipment, motor vehicles and computers	283,944 291,459 5,304 19,993 21,244	Depreciation 95,368 122,883 - 10,068	December 31, 2013  188,576  168,576  5,304  9,925  6,568

Included in PP&E are a number of capital projects in progress with a total cost to date of \$25.1 million (December 31, 2013: \$29.8 million). These projects primarily relate to various improvements to the Distribution System. Included in the total cost is an amount of \$0.6 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, 2013: \$5.0 million). In addition, line inventory with a cost of \$4.8 million (December 31, 2013: \$4.5 million) is included in T&D. Engine spares with a net book value of \$13.5 million (December 31, 2013: \$15.7 million) are included in Generation.

The capitalisation of 'Financing Costs' is calculated by multiplying the Company's Cost of Capital rate by the average work in progress for each month. The cost of capital rate for fiscal 2014 is 8.0% (2013: 7.5%) and will be adjusted annually. As a result, during the Second Quarter 2014, the Company recognised \$0.7 million in AFUDC, comparable to AFUDC recognised for the Second Quarter 2013. During the six month period ended June 30, 2014, the Company recognised \$1.2 million in AFUDC, compared to \$1.5 million for the six month period ended June 30, 2013.

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 \$0.9 million for the Second Quarter 2014, comparable to GEC for the Second Quarter 2013. GEC totalled \$1.9 million for the six months ended June 30, 2014, compared to GEC for the six months ended June 30, 2013 of \$1.8 million.

In accordance with the Licences, when an asset is impaired or disposed of before the original

estimated useful life, the cost of the asset is reduced and the net book value is charged to accumulated depreciation. This treatment is in accordance with the rate 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	As at June 30, 2014	As at December 31, 2013
Deferred debt issue costs	1,397	1,483
Miscellaneous other assets	<u>24</u>	<u>26</u>
Total	1,421	1,509

Deferred debt issue costs relate to transaction costs incurred in respect of financial liabilities. These costs are deferred on the balance sheet and are being amortized over the life of the related note using the effective-interest rate method.

# 9. Intangible Assets

Intangible Assets	Cost	Accumulated Amortisation	Net Book Value June 30, 2014
Deferred licence renewal costs	1,890	581	1,309
Datalink Ltd. deferred licence renewal costs	200	30	170
Computer Software	5,093	3,957	1,136
Other Intangible Assets in progress	127	-	127
Trademark Costs	<u>75</u>	-	75
Total	7,385	4,568	2,817
Intangible Assets	Cost	Accumulated Amortisation	Net Book Value December 31, 2013
Deferred licence renewal costs	1,890	534	1,356
Datalink Ltd. deferred licence renewal costs	200	23	177
Computer Software	4,877	3,819	1,058
Other Intangible Assets in progress	125	-	125
Trademark Costs	<u>75</u>	Ξ.	<u>75</u>
Total	7,167	4,376	2,791

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

	As at June 30, 2014	As at December 31, 2013
Fuel Cost Payable	27,474	25,478
Trade Accounts Payable & Accrued expenses	2,013	2,246
Accrued Interest	867	938
Dividends Payable	113	592
Other Accounts Payable	<u>2,368</u>	<u>2,379</u>
Total Accounts Payable	32,835	31,633

Included in Other Accounts Payable is an amount related to the fuel option contracts (see Note 14) of \$0.4 million at June 30, 2014 (nil at December 31, 2013).

# 11. Short-Term Financing

The Company has \$47.0 million of unsecured credit financing facilities with the Royal Bank of Canada ("RBC"). The total available was \$30.8 million at June 30, 2014 (\$44.7 million at December 31, 2013).

	Total Credit Financing Facilities June 30, 2014	Total Utilised June 30, 2014	Total Available June 30, 2014
Corporate Credit Card Line*	500	500	-
Letter of Credit	500	500	-
Operating, Revolving Line of Credit	7,500	169	7,331
Catastrophe Standby Loan Demand Loan Facility- Interim Funding	7,500	-	7,500
of Capital Expenditures	31,000	<u>15,000</u>	16,000
Total Included in Accounts payable and accrued expenses	47,000	16,169	30,831

A stand-by fee of 1/5 of 1% per annum in arrears is applied to the unused portion of the capital expenditure and catastrophe lines of the facility. A review fee of 1/8 of 1% of the total credit facilities is incurred annually in arrears.

# 12. Share Based Compensation Plans

#### Share Options:

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

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

Subject to certain amendments requiring shareholder approval, the Board of Directors may amend or discontinue the ESOP at any time without shareholder approval subject to TSX regulations, provided, however, that any amendment that may materially and adversely affect

any option rights previously granted to a participant under the Option Plan must be consented to in writing by the Participant.

Share Options	Six Months Ended June 30, 2014 Number of options	Six Months Ended June 30, 2014 Weighted average exercise price per share	Weighted Average Remaining Contractual Term ( <i>Years</i> )	Aggregate Intrinsic Value (\$ millions)
Outstanding at beginning of period	332,950	10.49	-	-
Granted	-	-	-	-
Exercised	(5,600)	8.76	-	-
Forefeited/Cancelled	-	-	-	-
Expired	=	Ξ.	=	Ξ
Outstanding, end of period	327,350	10.52	<u>5.98</u>	0.07
Vested, end of the period	238,850	10.84	5.34	0.13

Under the fair value method, the compensation expense was \$0.01 million for the six month period ended June 30, 2014 (June 30, 2013: \$0.01 million), resulting in a corresponding increase of Additional Paid in Capital.

# 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. In March 2014, 26,000 PSU's were granted. 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.

PSU Compensation expense was \$0.09 million for the three month period ended June 30, 2014 (June 30, 2013: nil), 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 29,105,771 and 28,856,720 for the three month period ended June 30, 2014 and June 30, 2013 respectively. The weighted average Class A Ordinary Shares outstanding were 29,120,811 and 28,877,609 for the six month period ended June 30, 2014 and June 30, 2013 respectively.

The weighted average of Class A Ordinary Shares used for determining diluted earnings were 29,115,415 and 28,873,960 for the three month period ended June 30, 2014 and June 30, 2013 respectively. The weighted average of Class A Ordinary Shares used for determining diluted earnings were 29,131,763 and 28,898,376 for the six month period ended June 30, 2014 and June 30, 2013 respectively. Diluted earnings per Class A Ordinary Share was calculated using the treasury stock method.

As at June 30, 2014 the outstanding options are not materially dilutive as the market price of common shares is below or marginally higher than the exercise price.

	Earnings (in \$ thousands) June 30, 2014	Weighted average shares (in thousands) June 30, 2014	Earnings per Common Shares June 30, 2014
Net earnings applicable to common shares	5,635		
Weighted Average share outstanding		29,106	
<b>Basic Earnings Per Common Share</b>			0.20
Effect of potential dilutive securities: Stock Options	=	<u>10</u>	<u> </u>
Diluted Earnings per Common Share	5,635	29,116	0.20
	Earnings (in \$ thousands) June 30, 2013	Weighted average shares (in thousands) June 30, 2013	Earnings per Common Shares June 30, 2013
Net earnings applicable to common shares	5,603		
Weighted Average share outstanding		28,857	
<b>Basic Earnings Per Common Share</b>			0.19
Effect of potential dilutive securities:			
Stock Options	=	<u>17</u>	Ξ
Diluted Earnings per Common Share	5,603	28,874	0.19

# 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-intime 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 June 30, 2014		June 30, 2014 As at December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long term debt, including current portion	205,000	210,385	219,000	214,110
Fuel Option Contracts <sup>1</sup>	427	427	-	-

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

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

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

The fair value of the fuel option contract reflects only the value of the heating oil derivative and not the offsetting change in the value of the underlying future purchases of heating oil. The derivatives' fair value shown in the below table reflects the estimated amount the Company would pay to terminate the contract at the stated date. The fair value has been determined using published market prices for heating oil commodities. The Company's current option contracts will expire in February 2015.

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	June 30, 2014 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	210,385	-	210,385	-
Fuel Option Contracts <sup>1</sup> 1 Carrying value of fuel option contracts included in Accounts Paya	427 able and Accrued expenses	<b>-</b>	427	-

# 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.

(\$millions)	Total	2014	2015-2016	2017-2018	2019 Onward
Accounts payable and accrued expenses	32.8	32.8	-	-	-
Consumer's Deposits and Advances for Construction	5.3	5.3	-	-	-
Letter of Credit	0.6	0.6	-	-	-
Short term debt	15.0	15.0			
Long term debt	205.0	14.0	25.0	29.4	136.6
Long term debt interest	<u>81.4</u>	<u>10.9</u>	<u>19.4</u>	<u>16.4</u>	<u>34.7</u>
Total	340.1	78.6	44.4	45.8	171.3

### 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 \$15 million (nil: December 31, 2013).

# 16. Finance Charges

The composition of finance charges were as follows:

(\$ thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Interest costs - long-term debt	2,900	2,887	5,871	5,721
Other interest costs	75	168	134	366
AFUDC *	<u>(629)</u>	<u>(703)</u>	(1,172)	(1,492)
Total	2,346	2,352	4,833	4,595

<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 \$0.04 million was recognised for the six months ended June 30, 2014 (\$0.17 million: six months ended June 30, 2013).

The composition of the expense was as follows:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Interest cost	78	67	156	134
Expected return on plan assets	(75)	(75)	(150)	(150)
Amortization of past service costs	20	62	40	124
Amortization of actuarial losses	=	<u>33</u>	Ξ	<u>66</u>
Total	23	87	46	174

This expense has been recorded in general and administrative expenses.

# 18. Foreign Exchange

The closing rate of exchange on June 30, 2014 as reported by the Bank of Canada for the conversion of US dollars into Canadian dollars was Cdn\$1.0670 per US\$1.00. The official exchange rate for the conversion of Cayman Islands dollars into US dollars as determined by the Cayman Islands Monetary Authority is fixed at CI\$1.00 per US\$1.20. Thus, the rate of exchange as of June 30, 2014 for conversion of Cayman Islands dollars into Canadian dollars was Cdn\$1.2804 per CI\$1.00 (December 31, 2013: Cdn\$1.2763).

### 19. 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 \$0.89 per IG of diesel fuel it imports. In addition, the Company pays customs duties of 15% on all other imports.

# 20. Commitments

The Company executed a primary fuel supply contract with Rubis Cayman Islands Limited ("Rubis") in September 2012 upon the expiration of its previous fuel supply contracts. Under the agreement the Company is committed to purchase approximately 60% of its diesel fuel requirements for its generating plant from Rubis. The approximate quantities per the contract on an annual basis are, by fiscal year in millions of IGs: 2014 – 11.3.

The Company also executed a secondary fuel supply contract with Sol Petroleum Cayman Limited ("Sol") (previously Esso Cayman Limited) in September 2012 and is committed to purchase approximately 40% of the Company's diesel fuel requirements for its generating plant from Sol. The approximate quantities per the contract on an annual basis are, by fiscal year in millions of IGs: 2014 - 7.6.

Both contracts expire July 31, 2014 with the option to renew for two additional 18 month terms. Renewal cannot occur more than six months in advance of the current contract expiry date. The point of delivery for fuel billing purposes remains at the Company's North Sound Road Power Plant compound. The Company is also responsible for the management of the fuel pipeline and ownership of bulk fuel inventory at the North Sound Road Power Plant.

As a result of the Company's bulk fuel inventory, the value of CUC's closing stock of fuel at June 30, 2014 was \$4.2 million (December 31, 2013: \$4.6 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.

#### 21. Transactions with Related Parties

Miscellaneous payables to Fortis Turks & Caicos, also a subsidiary of Fortis Inc., were \$1.1 thousand at June 30, 2014 (nil as at December 31, 2013) for travel expenses. Miscellaneous payables to Fortis Inc., the Company's majority shareholder, totalling \$28.4 thousand were outstanding at June 30, 2014 (\$9.8 thousand as at December 31, 2013) for labour, hurricane preparedness and travel expenses and are included within the Accounts Payable and Accrued Expenses on the Balance Sheet. Miscellaneous receivables from Fortis Inc. were \$11.2 thousand at June 30, 2014 (nil as at December 31, 2013) for travel expenses.

# 22. Comparative Figures

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 E-mail: investor@cuc.ky

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.

Assistant to the Company Secretary P.O. Box 38 Grand Cavman KY1-1101 CAYMAN ISLANDS

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