Hawaiian Electric Industries, Inc. (HE) Rating: MP
June 1, 1998 Price: $38.25

Financial Data and Valuation Parameters

Year	EPS	P/E Abs.	P/E Rel.(a)	Stock Performance		Cash Flow/Sh (b)		Capitalization (b)	
1997	$2.91	13.1 X	0.56 X	52-Week Range	43-34	Before Dividends	$4.37	Market Capitalization (mn)	$1,220
LTM (3/98)	2.97	12.9	0.60	Indicated Dividend	$2.48	After Dividends	1.89	Shares Outstanding (000s)	31,895
1998E	3.00	12.8	0.59	Yield	6.48%	1998E Cap Ex	5.25	Book Value/Share	$25.54
1999E	3.15	12.1	0.61			Free Cash Flow	Nil	Price/Book Value	1.50X
								Common Equity Ratio	57.9%
								Average ROE	11.5%

(a)Relative to the S&P 500 multiple
(b)As of December 31, 1997.

[illegible]

Hawaiian Electric Industries' utility subsidiaries continue to experience weak electric sales growth in a sluggish local economy. The company's unregulated subsidiaries, HEI Power Corporation (independent power) and American Savings Bank, are expected to drive earnings growth over the long term. We continue to rate the stock a market performer and have maintained a point estimate for earnings of $3.00 per share (range of $2.95-$3.00) in 1998 and $3.15 in 1999.

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Highlights of the May 29th analyst meeting follow.

Sluggish Hawaiian Economy Slows Utility Earnings Growth

Hawaii's economy, in a slump for most of the 1990s, continues to be a drag on utility (70% of consolidated net income) earnings growth. Most of Hawaiian Electric's long-term earnings growth is expected to come from its unregulated subsidiaries, American Savings Bank and HEI Power Corporation. Tourism, accounting for 25% of the state's economy (or 40%, after accounting for secondary effects) is expected to remain flat for 1998, after a first-quarter drop in Asian visitors (most from Japan) that was somewhat offset by a slight rise in North American visitors. Management noted that the military (the second-largest component of the state economy and Hawaiian Electric's single-largest customer) currently has no plans to reduce its armed forces in Hawaii, and the company expects federal government spending to remain stable over the near term. Hawaiian Electric is forecasting a slow economic recovery for the state over the next two years, with about 1% annual real growth.

The company's utility subsidiaries experienced a 0.3% decrease in kilowatt-hour (Kwh) sales due to cooler weather and the slow economy, and the company is forecasting five-year average annual growth of 1% (flat through 2000 and rising thereafter; see Table 7). To address the slow sales growth, management has been pursuing cost containment measures, reducing its five-year utility construction budget by $100 million (20%) to $592 million for the period 1998-2002 [net of customer contributions in aid of construction and allowance for funds used during construction (AFC)]. Approximately 70% of the construction budget is for transmission and distribution (T&D) facilities. Table 8 provides five-year capital expenditure budgets from 1993-2002. The company has also increased productivity and held utility operation and maintenance (O&M) expenditures approximately level for the past three years, with $186 million spent in 1997. Table 9 provides O&M expenditures from 1993-1997.

The company has also been pursuing strategies geared toward protecting existing sales, including an energy partnership agreement with the military. The utilities expect to receive $2 million in shareholder incentives in 1998 from its demand-side management (DSM) programs, which allow the company to retain 10% of related after-tax savings (outside of the regulatory rate of return).

The company in March began purchasing shares on the open market for its dividend reinvestment plan

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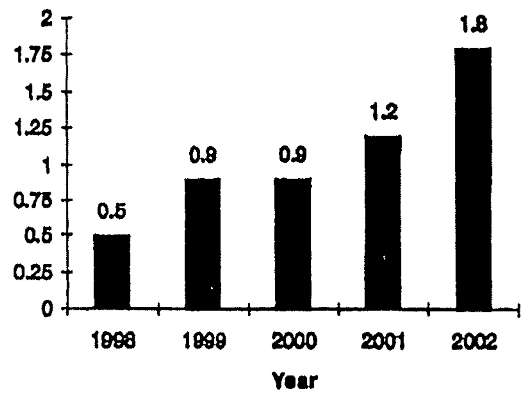
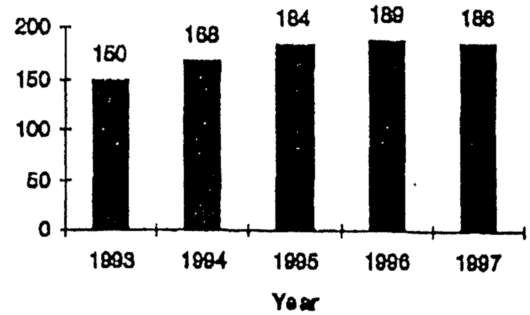
Table 7: Kilowatt-Hour Sales Growth Forecast, 1998E-2002E
(percent)



E-estimate
Source: Hawaiian Electric Industries, Inc.

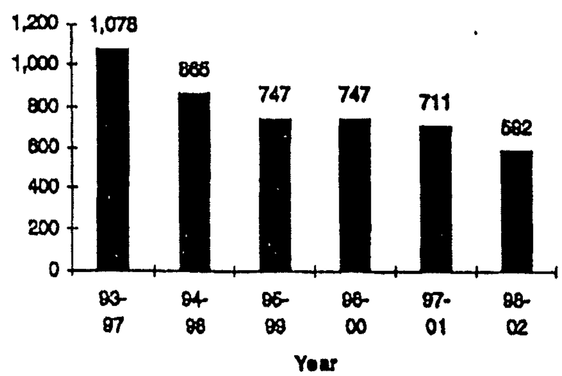
Table 9: Operation and Maintenance Expenditures, 1993-1997*
(millions of $)



* Excluding demand-side management (DSM) and integrated resource plan (IRP).

Source: Hawaiian Electric Industries, Inc.

Table 8: Forecasted Five-Year Capital Expenditure Budget, 1993-2002E
(millions of $)



E-estimate
Source: Hawaiian Electric Industries, Inc.

(DRIP) and 401(k) retirement plans. Management intends to continue these purchases until new equity is needed for HEI Power (see discussion below).

Regulatory Update

In March 1998, Hawaiian Electric Company (HECO; Oahu's utility) filed to close its March 1997 show-cause order, based largely on the fact that HECO's 1997 return on common equity (ROE) of 10.3% was below its allowed ROE of 11.4%. Management noted that the Consumer Advocate does not oppose the company's request.

Maui Electric Company (MECO) in January 1998 filed for a $22.4-million rate increase (based on an ROE of 12.75%) for recovery of costs related to the operation of Maalaea unit 17, expected to come on-line in late 1998.

Hawaii Electric Light Company (HELCO; the big island's utility) filed in March 1998 for $17.3 million in rate relief (based on an ROE of 12.5%) that includes recovery of costs associated with the installation of 40 Mw of generation capacity at the utility's Keahole power plant and $7.1 million related to the utility's purchased-power contracts with Encogen. Two 20-Mw combustion turbines were purchased in 1994 for Keahole, but installation has been postponed due to various environmental and regulatory approval delays. Completion of the project is anticipated later this year. Management stated that the delays have caused the average cost of generation from the turbines to rise as high as $2,000 per kilowatt (Kw), substantially more than the embedded cost of existing generation (but we would also note that the cost of new generation would be high for any new developer).

HELCO has been recognizing approximately $400,000 per month in AFC at Keahole. This non-cash revenue will drop off the books after the project goes commercial, and management will have to make a case to the Public Utility Commission (PUC) that the project is cost effective for it to fully allow the facility into rate base upon completion.

Indeed, Hawaiian Electric's utilities accrued $17.0 million (53¢ per share) in AFC in 1997 and we estimate that this will increase to $30.7 million (96¢ per share) in 1998, approximately 70% for T&D assets. Regardless of any uncertainty about the ability of the company to obtain adequate rate relief for its Keahole project, we believe that the PUC will be constructive toward tariff increases for the company's T&D expenditures.

Competitive Issues

The state is only in the preliminary stages of electric competition discussions and there is currently no timetable for consideration of changes to the existing regulatory structure. Despite high electric rates, Hawaiian Electric's utilities enjoy several competitive advantages in Hawaii. These include: the absence of an intertie between the islands and the mainland; an absence of natural gas, which would preclude potential competitors from building relatively inexpensive combined-cycle gas turbine facilities; and projected demand load that would not require additional generation units until 2009. The company's embedded cost of generation is low ($160 per Kw on Ohau) compared with the cost of new generation (about $900 per Kw), and competing independent power producers who might wish to build generation on the islands do not have any siting or permitting advantages.

Other advantages include: a low risk of potentially stranded assets as the utilities' generating assets are only 20% of total utility plant and do not include any nuclear generation; exemption from the acid rain provisions of the Clean Air Act, and low-cost long-term debt. Although management views new technologies, such as fuel cells and microturbines, as potential competitive threats, the company also views them as opportunities.

On June 5, Hawaiian Electric intends to present a collaborative white paper to the PUC regarding performance-based ratemaking (PBR), which has not been employed in Hawaii to date. The proposal will include a band of 100 basis points on either side of an authorized ROE within which no rate adjustments would be required and no show-cause orders would be issued. Beyond the band, there would be either a sharing of earnings (based on an assessment of various performance criteria) or a mechanism for adjusting rates should earnings fall below the band threshold.

Unregulated Businesses

The company's banking subsidiary, American Savings Bank (ASB), is expected to be the main driver of long-term earnings growth for Hawaiian Electric. We believe that it is the strongest bank in the state, with the recent acquisition of Bank of America's Hawaii operations and a 22% share of the market. Management noted that first-quarter 1998 net income from operations from ASB increased 18% over first-quarter 1997, due primarily to the acquisition. This contributed to a 13% rise in net income at the holding company over the same period. The bank earned $28.7 million (90¢ per Hawaiian Electric share) from continuing operations in 1997, and we believe that income will grow modestly to about $30 million (94¢ per Hawaiian Electric share) in 1998.

However, management indicated that it may attempt to increase its loan reserves this year and this could reduce the bank's earnings growth rate. The company also noted that although the number of deposits has been rising recently, the total dollar amount of deposits has remained largely flat. Management's goal for ASB is to develop its commercial lending business (it has traditionally been strongest in the residential market). Over the long run, the company may consider an acquisition outside the state, but no strategy along these lines has been formulated yet.

HEI Power, the company's independent power subsidiary, is engaged in projects in China, the Philippines, and the Pacific Islands. Hawaiian

Electric's board of directors recently approved an increase in equity investment at HEI Power Corp. of $75 million over the next three years. The company is mainly interested in small projects (less than 200 Mw) and is currently developing a steel mill power plant in China for approximately $600 per Kw, one of the lowest-cost projects currently being done in that country.