KT1.1 T3, S2, Att. 1

Note: this is attachment 1 to Response to TechCon Question T3, S2 in Exhibit KT1.1

ST.THOMAS ENERGY SERVICES INC.

Financial Statements

December 31, 2010

ST.THOMAS ENERGY SERVICES INC.

Financial Statements

For the Year Ended December 31, 2010

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INDEPENDENT AUDITORS' REPORT

To the shareholder of **St. Thomas Energy Services Inc.**

Report on the Financial Statements
We have audited the accompanying financial statements of **St. Thomas Energy Services Inc.**, which comprise the balance sheet as at December 31, 2010, and the statements of operations, retained earnings, and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements present fairly, in all material respects, the balance sheet of **St. Thomas Energy Services Inc.** as at December 31, 2010, and the statements of operations, retained earnings, and cash flow for the year then ended in accordance with Canadian generally accepted accounting principles.

St. Thomas, Ontario
March 2, 2011

Graham Scott Enns LLP
CHARTERED ACCOUNTANTS
Licensed Public Accountants

ST.THOMAS ENERGY SERVICES INC.

Balance Sheet
As At December 31, 2010

	2010 $	2009 $
ASSETS		
CURRENT ASSETS		
Cash (Note 6)	**121,297**	-
Accounts receivable (net of allowance $2,660; 2009 - $32,000)	**972,337**	652,792
Inventory	**781,342**	394,333
Payment in lieu of taxes recoverable	-	175,252
Prepaid expenses	**324,549**	139,629
Current portion - Note receivable	**14,891**	56,944
Current portion - Due from related parties (Note 12)	**1,170,628**	1,371,442
	3,385,044	2,790,392
PROPERTY, PLANT & EQUIPMENT (NOTE 4)	**1,786,504**	1,638,051
OTHER ASSETS		
Note receivable	-	14,891
Intangible assets (Note 3)	**249,460**	13,235
Future payment in lieu of taxes recoverable	**289,600**	345,200
Due from St. Thomas Holding Inc. (Note 12)	**1,323,166**	2,243,795
Note Receivable from St. Thomas Holding Inc. (Note 12)	**3,500,000**	3,500,000
	5,362,226	6,117,121
TOTAL ASSETS	**10,533,774**	10,545,564
LIABILITIES		
CURRENT LIABILITIES		
Bank indebtedness (Note 6)	-	484,729
Accounts payable and accrued liabilities	**1,208,259**	818,927
Due to City of St. Thomas (Note 12)	**1,973,270**	2,024,706
Payment in lieu of taxes payable	**5,286**	-
Current portion of long-term debt (Note 7)	**46,994**	44,440
Current portion of employee retirement liabilities (Note 5)	**107,000**	91,000
	3,340,809	3,463,802
DEFERRED REVENUE (NOTE 9)	**66,662**	69,996
LONG-TERM DEBT (NOTE 7)	**102,241**	149,235
EMPLOYEE RETIREMENT BENEFIT LIABILITIES (NOTE 5)	**1,127,894**	1,106,775
	4,637,606	4,789,808
SHAREHOLDER'S EQUITY		
SHARE CAPITAL (NOTE 10)	**4,296,055**	4,296,055
RETAINED EARNINGS	**1,600,113**	1,459,701
	5,896,168	5,755,756
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	**10,533,774**	10,545,564

See accompanying notes to the financial statements.

ST.THOMAS ENERGY SERVICES INC.

Statement of Retained Earnings
For the Year Ended December 31, 2010

	2010 $	2009 $
BALANCE, BEGINNING OF YEAR	**1,459,701**	1,435,253
Net earnings for the year	**140,412**	24,448
BALANCE, END OF YEAR	**1,600,113**	1,459,701

See accompanying notes to the financial statements.

ST.THOMAS ENERGY SERVICES INC.

Statement of Operations
For the Year Ended December 31, 2010

	2010	2009
	$	$
REVENUES		
Services to related parties (Note 12)	9,850,659	6,502,204
Services to unrelated parties	408,979	333,493
Other	10,322	8,952
Interest	5,579	14,404
	10,275,539	6,859,053
OPERATING EXPENSES		
Administrative wages and benefits	1,505,485	1,252,837
Administrative	964,324	741,877
Advertising and business promotion	207,782	68,102
Amortization	313,196	255,263
Materials and subcontracting	4,884,134	2,551,178
Operational wages and benefits	2,001,311	1,782,745
Professional services and consulting	18,178	18,338
Vehicle expenses	123,708	144,428
	10,018,118	6,814,768
EARNINGS FROM OPERATIONS	257,421	44,285
GAIN ON SALE OF PROPERTY, PLANT AND EQUIPMENT	-	2,100
EARNINGS BEFORE PAYMENTS IN LIEU OF TAXES	257,421	46,385
PROVISION FOR PAYMENTS IN LIEU OF TAXES (NOTE 11)		
Current	61,409	1,237
Future	55,600	20,700
	117,009	21,937
NET EARNINGS FOR THE YEAR	140,412	24,448

See accompanying notes to the financial statements.

ST.THOMAS ENERGY SERVICES INC.

Statement of Cash Flow
For the Year Ended December 31, 2010

	2010 $	2009 $
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings for the year	**140,412**	24,448
Adjustments:		
Amortization of property, plant and equipment	**313,196**	255,262
Change in employment retirement benefit liabilities	**37,118**	23,844
Gain on disposal of property, plant and equipment	**-**	(2,100)
Future income tax expense	**55,600**	20,700
	546,326	322,154
Changes in non-cash working capital (Note 13)	**(324,937)**	189,372
Cash flows from operating activities	**221,389**	511,526
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	**(461,648)**	(271,461)
Proceeds on disposal of property, plant and equipment	**-**	2,100
Decrease in note receivable	**56,944**	52,973
(Increase) decrease in intangible assets	**(236,225)**	26,470
Cash flows used in investing activities	**(640,929)**	(189,918)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Decease) increase in due to City of St. Thomas	**(51,436)**	24,808
Repayment of long-term debt	**(44,440)**	(42,025)
Decease (increase) in due from St. Thomas Energy Inc.	**117,487**	391,170
Decease (increase) in due from St. Thomas Holding Inc.	**920,628**	(684,868)
Decease (increase) in due from 2154310 Ontario Inc.	**83,327**	(120,851)
Cash flows from (used in) financing activities	**1,025,566**	(431,766)
NET CHANGE IN CASH	**606,026**	(110,158)
CASH (BANK INDEBTEDNESS), BEGINNING OF YEAR	**(484,729)**	(374,571)
CASH (BANK INDEBTEDNESS), END OF YEAR	**121,297**	(484,729)
SUPPLEMENTAL INFORMATION:		
Interest Paid	**17,221**	14,513
Income Taxes Recovered	**(119,129)**	(94,445)

See accompanying notes to the financial statements.

1. NATURE OF THE BUSINESS

St. Thomas Energy Services Inc. (the Corporation) was incorporated under the Business Corporations Act (Ontario) on November 3, 2000 and is wholly owned by St. Thomas Holding Inc. The principal business of St. Thomas Energy Services Inc. is to provide service support to St. Thomas Energy Inc. and other organizations within the St. Thomas area.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

In the opinion of management, the financial statements have been prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below:

Accounting Estimates

The preparation of these financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting period. These estimates are reviewed periodically, and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

In particular, the corporation uses estimates when accounting for certain items, including:

- Allowance for doubtful accounts
- Net realizable value of inventory
- Useful lives of tangible assets
- Future income taxes
- Revenues
- Employee benefit plans

Financial Instruments

The corporation has adopted Sections 3855, "Financial Instruments- Recognition and Measurement", 3862, "Financial Instruments – Disclosures", and 3863, "Financial Instruments - Presentation", of The Canadian Institute of Chartered Accountants (CICA) Handbook. These standards provide recommendations on recognizing and measuring financial assets and financial liabilities.

These standards require that all financial instruments be classified into one of five categories: held-for-trading, available for sale, held-to-maturity, loans and receivables or other liabilities. All financial instruments are measured on the balance sheet at fair value upon initial recognition. Subsequent measurement depends on the initial classification of the instrument. The company has classified its financial instruments as follows: accounts receivable, notes receivable, and due from related parties are classified as loans and receivables; bank indebtedness, accounts payable and due to related parties are classified as other liabilities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue Recognition

Revenue is recognized when realized and earned. Revenue is considered to be realized and earned when persuasive evidence of an arrangement exists, the selling price is fixed or determinable, collection is reasonably assured and performance requirements are met. Specifically, the company recognizes revenue from services on the completion of a work order.

Water Accounts Receivable

Water and sewer accounts receivable are maintained by the corporation on behalf of the City of St. Thomas.

Property, Plant & Equipment

Equipment is stated at cost and is amortized on the straight-line basis over the estimated service life. The amortization rates are as follows:

	Life Years	Rate
Substations	30	3.33%
Fibre optics	25	4.00%
Rolling stock (over 3 tons)	8	12.50%
Rolling stock (under 3 tons)	5	20.00%
Water heater rental units	10	10.00%
Miscellaneous equipment	10	10.00%
Computers	5	20.00%
Office	10	10.00%

When non-grouped equipment is sold or otherwise disposed of, the related cost and accumulated amortization are removed from the respective accounts and any gain or loss on disposition is recognized in earnings. Grouped property, plant and equipment are, by their nature not readily identifiable as individual assets. The related cost and accumulated amortization is therefore removed from the respective accounts at the end of their estimated useful life regardless of actual service life. Any proceeds on disposition are recognized in earnings in the year of disposition.

Intangible assets

Intangible assets represent computer applications software. These assets are carried at cost net of accumulated amortization. CICA Handbook Section 3064, Goodwill and Intangible Assets, sets out the standards for recognition, measurement, presentation and disclosure of intangible assets. The Corporation has reclassified other assets previously classified as deferred charges to intangible assets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined at laid down cost on the average cost basis.

Pension Agreements

The corporation makes contributions to the Ontario Municipal Employees Retirement System Pension Fund (OMERS), which is a multi-employer plan, on behalf of members of its staff. The plan is a contributory defined benefit plan which specifies the amount of the retirement benefit to be received by employees based on length of service and rates of pay.

Corporate Income and Capital Taxes

Under the Electricity Act, 1998, St. Thomas Energy Services Inc. is required to make payments in lieu of corporate taxes to Ontario Electric Financial Corporation (OEFC). These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) as modified by the Electricity Act, 1998, and related regulations.

The future tax method of income tax allocation is used by the corporation. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of the assets and liabilities. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to reverse.

3. INTANGIBLE ASSETS

	Cost	Accumulated Amortization	**2010**	2009
	$	$	**$**	$
Computer applications software	252,355	2,895	**249,460**	13,235

The company implemented a new Harris customer information system (CIS) in December 2010 and a Harris financial management system is planned to be implemented during 2011. The Company plans to amortize these costs over a three year period from their respective implementation dates. As at December 31, 2010, costs incurred of $148,125 on the financial information system were capitalized and are included in the cost of $252,355 with amortization to commence in fiscal 2011. Amortization of $2,895 was recorded on the CIS software in 2010.

Billing software costs from the previous software had initial capitalized costs of $133,477 and the remaining balance at December 31, 2009 of $13,235 was amortized and removed from the books in 2010.

4. PROPERTY, PLANT & EQUIPMENT

	Cost $	Accumulated Amortization $	**2010** $	2009 $
Fibre optics	489,012	106,667	**382,345**	392,377
Mobile substation	400,848	180,793	**220,055**	232,999
Rolling stock	1,387,650	1,118,300	**269,350**	202,681
Water heater rental units	2,105,578	1,486,293	**619,285**	607,657
Miscellaneous equipment	859,104	750,717	**108,387**	80,026
Computers	1,059,906	948,044	**111,862**	76,372
Office	311,766	236,546	**75,220**	45,939
	6,613,864	4,827,360	**1,786,504**	1,638,051

5. EMPLOYEE RETIREMENT BENEFIT LIABILITIES

Employee future benefits are liabilities of the Company to its employees for benefits provided to retirees until they reach 65 years of age as at December 31, 2010. The last actuarial review was completed as at December 31, 2010. The significant assumptions are as follows:

Consumer Price Index	2.0%
Discount rate	5.5%
Assumed salary increase per annum	3.3%
Healthcare cost increase	5.0% - 8.0%
Average retirement age	57 years

	2010 $	2009 $
Accrued benefit obligation, January 1	**1,197,775**	1,173,931
Current service cost	**40,680**	32,249
Interest cost	**66,394**	59,091
Actuarial loss	**7,407**	-
Benefits paid for the year	**(77,362)**	(67,496)
Accrued benefit obligation, December 31	**1,234,894**	1,197,775
Less: current portion	**107,000**	91,000
	1,127,894	1,106,775

The amount contributed to OMERS for 2010 was $203,568 (2009 - $174,159) for current services.

6. BANK OF NOVA SCOTIA FACILITY

During the year, the Company's banking facilities were changed such that the Bank of Nova Scotia created a new credit facility for the Company's sole shareholder, St. Thomas Holding Inc., encompassing borrowing facilities for all its subsidiary companies. This replaced the separate facilities of the subsidiary companies, including that of the Company.

Under the new facility, the Company has access to the following available credit facilities:
(1) Operating line of $8,000,000, by way of lines of credit, bearing interest at bank prime (3% at December 31, 2010) or by way of bankers acceptances;
(2) 364 Revolving Term Facility of $17,000,000, convertible to non-revolving 2 year term debt. Interest is available at bank prime plus 0.3% per annum or can be fixed at market rates. In addition, the interest rate on debt of up to $7,000,000 (cumulative) can be fixed by way of interest rate swap at market rates;
(3) Equipment Financing Revolving Line with Scotia Leasing of $500,000;
(4) Standby Letter of Credit facility (available only for the Independent Electricity System Operator commitment from St. Thomas Energy Inc.).

The Company has provided to the Bank of Nova Scotia an unlimited guarantee towards the above facilities, secured by a general security agreement over all present and future personal property with appropriate insurance coverage.

As at December 31, 2010, the following amounts were drawn on the facilities by St. Thomas Holding Inc. and its subsidiary companies, for which the Company has provided unlimited guarantees:

Operating Line	$ 5,800,000
Standby Letters of Credit	$ 2,112,910
Revolving Term Facility	$ 7,593,750
Equipment Financing Facility	$ 149,235

7. LONG TERM DEBT

	2010	2009
	$	$
Term note - Bank of Nova Scotia, repayable in blended monthly instalments of $4,513, prime plus 1.6% (prime was 3.0% at Dec. 31), due December 2013, specifically secured by a vehicle.	**149,235**	193,675
Less: Current portion	**46,994**	44,440
	102,241	149,235

Interest expense for the year on long term debt was $7,064 (2009-$8,684).

8. LONG TERM DEBT (continued)

Principal repayments are scheduled as follows:

	$
2011	46,994
2012	49,694
2013	52,547

9. DEFERRED REVENUE

The corporation has entered into a twenty five year contract with Hydro One Telecom Inc. for the use of a portion of St. Thomas Energy Services Inc. fibre optic line in the City of St. Thomas. As part of this contract Hydro One Telecom Inc. has paid in advance to the corporation $83,328 to be amortized into income over the life of the contract ($3,333 annually). There are 20 years remaining in the life of the contract.

10. SHARE CAPITAL

	2010 $	2009 $
Authorized Capital:		
Unlimited common shares		
Issued Capital:		
1,001 Common shares	4,296,055	4,296,055

11. PROVISION FOR PAYMENT IN LIEU OF TAXES

	2010 $	2009 $
Income before provision for PIL's	257,421	46,385
Combined rate of federal and provincial income tax	31%	33%
Provision for PIL's at statutory rate	79,801	15,307
Increases resulting from:		
Change in corporate rate for future taxes	18,600	5,230
Other	18,608	1,400
	117,009	21,937

12. RELATED PARTY TRANSACTIONS

During the year, the Company had business transactions with St. Thomas Energy Inc., St. Thomas Holding Inc., 2154310 Ontario Inc., Tiltran Services Inc., Lizco Sales Inc., Tall Trees Inc. and the City of St. Thomas. The Company contracts with St. Thomas Energy Inc. to build and maintain their capital infrastructure as well as bill and collect their sales revenues. The terms of the transactions are as set out in the services agreement and are adjusted to attempt to correspond with market rates. The Company contracts with St. Thomas Holding Inc., 2154310 Ontario Inc., Tiltran Services Inc., Lizco Sales Inc. and Tall Trees Inc. to provide accounting and administrative services. The Company contracts with the City of St. Thomas for the billing and collecting their water and sewer charges.

The particulars of these transactions and balances owing from or to these corporations for the years ended December 31, were as follows:

	2010	2009
	$	$
Service revenue transactions during the year:		
St. Thomas Energy Inc.	**8,256,548**	5,269,715
St. Thomas Holding Inc.	**725,625**	549,712
City of St. Thomas	**636,562**	430,553
Interest received on intercompany loans	**-**	2,413
Building rental payments to St. Thomas Energy Inc.	**273,182**	265,225
Management service fees to Tiltran Services Inc., Lizco Sales Inc. Tal Trees Inc. and 2154310 Ontario Inc.	**191,436**	163,201
Balances at end of year:		
Amounts due from related parties (current)		
St. Thomas Energy Inc.	**1,133,104**	1,250,591
2154310 Ontario Inc.	**37,524**	120,851
	1,170,628	1,371,442
Note Receivable from St. Thomas Holding Inc. (long-term)	**3,500,000**	3,500,000
Due from St. Thomas Holding Inc.	**1,323,166**	2,243,795
Amounts due to City of St. Thomas	**1,973,270**	2,024,706

The Note Receivable from St. Thomas Holding Inc. was advanced on January 1, 2008, and is non interest bearing. The entire principal is due in full on January 3, 2013.

13. CHANGES IN NON-CASH WORKING CAPITAL

Accounts receivable	**(319,545)**	27,002
Inventory	**(387,010)**	25,389
Prepaid Expenses	**(184,920)**	20,505
Accounts payables and accrued liabilities	**389,333**	24,127
Deferred revenue	**(3,333)**	(3,333)
Current income taxes payable	**180,538**	95,682
	(324,937)	189,372

14. ECONOMIC DEPENDENCY

The Company derives the majority of its revenue from related parties and as a result, the Company is economically dependent on these related parties to ensure its ability to operate as a going concern.

15. COMMITMENTS

At December 31, 2010, the Company was committed to operating lease payments for computer hardware and automobiles in the following approximate amounts over the next five years:

	$
2011	18,129
2012	15,657
2013	14,448
2014	6,609
2015	-

16. CONTINGENT LIABILITIES

The company has made guarantees on the corporate group's lending faculties. See note 6.

17. NEW ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements that have been issued but are not yet effective, and have a potential implication for the company, are as follows:

International financial reporting standards
St. Thomas Energy Inc. is a rate regulated enterprise and as such is required to adopt international Financial Reporting Standards (IFRS). The Canadian Accounting Standards Board (AcSB) had initially confirmed that all publicly accountable enterprises, including those organizations with rate regulated activities (RRA), would be required to adopt for fiscal periods beginning on or after January 1, 2011. On September 28, 2010, the AcSB decided to permit rate-regulated entities to defer their IFRS implementation to January 1, 2012.

Under the standards of the CICA, St. Thomas Energy Services Inc. would be required to adopt IFRS or alternatively the Accounting Standards for Private Enterprises for its fiscal period beginning January 1, 2011. St. Thomas Energy Services Inc. intends to adopt IFRS but for consolidation purposes it intends to adopt IFRS in the same year as it's rated regulated sister company on January 1, 2012. The company plans on preparing qualified financial statements for the fiscal 2011 transition period.

18. CAPITAL DISCLOSURES

The company's objectives when managing capital are to safeguard the company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. The company considers its capital structure to consist of shareholder's equity, payable to related parties, long-term debt, and cash and bank indebtedness.

The company manages it capital and makes adjustments to it in light of economic conditions. The company will balance its overall capital structure through the payment of dividends, the repayment of debt or by undertaking other activities as deemed appropriate under specific circumstances.

The company's borrowing are undertaken through a banking facility in place for its parent company St. Thomas Holding Inc. That facility is subject to a number of financial covenant restrictions typically associated with long-term debt, which are based on the consolidated financial results of St. Thomas Holding Inc. As at December 31, 2010, St. Thomas Holding Inc. is in compliance with all of its financial covenants and limitations.

19. FINANCIAL INSTRUMENTS

The company has adopted CICA Handbook Section 3861 - Financial Instruments for disclosure purposes as the Company's financial instruments are not subject to disclosure requirements under Section 3862 or 3863 of the CICA Handbook.

Accounts receivable and balances due from related party are classified as loans and receivables. Accounts payable and accrued liabilities, and due to related party are classified as other financial liabilities.

Foreign currency risk

The company has no significant sales or purchases in foreign currencies.

Credit risk

The company does not have any significant exposure to any individual customer. The company may require payment guarantees, such as a letter of credit or customer deposits.

Fair value

The carrying value of accounts receivable, inventory, note receivable, accounts payable and accrued liabilities and long-term debt approximate their fair values due to the near-term maturity of these instruments. The carrying value of amounts due to related parties may not approximate fair value as they are non-interest bearing and there are no specific terms of repayment.