FINANCIAL STATEMENTS

KITCHENER-WILMOT HYDRO INC.

January 1 – December 31, 2004

March 10, 2005

REPORT TO SHAREHOLDERS:

CORPORATION OF THE CITY OF KITCHENER

CORPORATION OF THE TOWNSHIP OF WILMOT

We are pleased to provide you with the fourth Annual Report of Kitchener-Wilmot Hydro Inc. for the period ending December 31, 2004.

As required by Provincial Legislation the former Hydro-Electric Commission of Kitchener-Wilmot ceased operations on July 31, 2000 and the new successor local distribution company Kitchener-Wilmot Hydro Inc. was created effective August 1, 2000 by Municipal Transfer By-Laws of the City and Township. This Annual Report represents the fourth full fiscal year of operations for the new Corporation.

Although 2004 was again a year of enormous change for Ontario's electricity industry, Kitchener-Wilmot Hydro Inc. continued to meet the challenge of responding effectively and in a timely manner to numerous changes mandated by the Ontario Energy Board and the Ministry of Energy. A new provincial government introduced Bill 4 which removed the previous single commodity price and introduced effective April 1, 2004 a new two-tiered pricing system. Further revisions are anticipated for 2005 with the change to a regulated price plan for low volume and designated customers.

During the year the company achieved further efficiencies in the way electrical power and other services are delivered to our customers. This improvement reflects the success of our distribution asset management strategy. The Board continues to support the need for investment in system upgrades and expansion which is vital to ensuring our continued ability to deliver safe and reliable electricity.

Kitchener-Wilmot Hydro Inc. achieved a new safety milestone in 2004, reaching 500,000 worker hours without a lost-time accident. We will continue to promote a healthy and safe work environment for the corporation's valued employees.

2004 was a year of substantial growth in terms of new customers. A total of 2,014 new customers were connected to our system. Kilowatt hour sales decreased approximately 23 million kWhrs as a result of experiencing a cooler summer. Although operating revenue decreased due to lower sales, operating costs were effectively controlled and the corporation remains in a strong financial position for the future.

Your Corporation continues to deliver electricity to the citizens of our communities with the lowest local residential retail rates. By controlling costs the Corporation continues to have the lowest local distribution costs amongst all the major utilities in the province. At the same time, the system infrastructure is continually being refurbished and enhanced in order to continue to provide a reliable and a safe supply of electricity. The Corporation continues to provide value to its shareholders, the City of Kitchener and the Township of Wilmot, as well as to its customers and provides a supporting base for economic development in the communities we serve.

In conclusion, we wish to thank the Board and all staff for their dedication, support and commitment to excellence which has provided us with a solid base to meet future unknown challenges as we move along the path of deregulation with its ever changing regulation environment.

B. LEE, CHAIR **R. CHARIE, PRESIDENT & C.E.O.**

KPMG LLP
Chartered Accountants
20 Erb Street West
Marsland Centre 3rd Floor
Waterloo ON N2L 1T2

Telephone (519) 747-8800
Fax (519) 747-8830
Internet www.kpmg.ca

AUDITORS' REPORT

We have audited the balance sheet of Kitchener-Wilmot Hydro Inc. as at December 31, 2004 and the statements of operations, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with the Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Waterloo, Canada
February 25, 2005

Kitchener-Wilmot Hydro Inc.

BALANCE SHEET

As at December 31st

	2004 $	2003 $
ASSETS		
Current assets		
Cash and cash equivalents	**25,388,538**	25,779,810
Accounts receivable (note 4)	**13,984,380**	12,313,456
Accounts receivable from related parties (note 5)	**133,738**	496,563
Unbilled revenue receivable	**16,143,900**	14,646,500
Inventories (note 19)	**2,730,039**	2,428,205
Prepaid expenses	**337,257**	419,889
Accrued interest receivable	**68,547**	52,212
Current portion of regulatory assets (note 8[i])	**967,135**	-
Total current assets	**59,753,534**	56,136,635
Capital assets – net of accumulated amortization (note 6)	**129,224,134**	124,912,415
Computer software – net of accumulated amortization (note 7)	**468,678**	421,102
Regulatory assets (note 8 [i])	**4,977,243**	6,060,949
Reserve for impairment of regulatory assets (notes 2 [b] & 3 [ii])	**(3,444,911)**	(3,444,911)
Total assets	**190,978,678**	184,086,190
LIABILITIES and SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 9)	**16,139,821**	16,097,112
Payments-in-lieu of corporate income taxes payable	**95,658**	127,761
Current portion of customers deposits	**2,869,400**	2,155,000
Construction and property deposits	**3,692,135**	3,362,404
Current portion of regulatory liabilities (note 8 [ii])	**339,750**	-
Total current liabilities	**23,136,764**	21,742,277
Long-term liabilities		
Long-term debt (note 10)	**76,962,142**	76,962,142
Customer deposits	**2,098,041**	2,155,097
Post-employment benefits (note 12)	**4,612,979**	4,392,363
Regulatory liabilities (note 8 [ii])	**5,681,890**	3,694,971
Total long-term liabilities	**89,355,052**	87,204,573
Total liabilities	**112,491,816**	108,946,850
Shareholders' equity		
Share capital – common shares (note 13)	**63,689,499**	63,689,499
Retained earnings	**14,797,363**	11,449,841
Total shareholders' equity	**78,486,862**	75,139,340
Total liabilities and shareholders' equity	**190,978,678**	184,086,190

Approved by the Board of Directors

B. Lee, Chair

R. Charie, President & C.E.O. / Director

See accompanying notes

Kitchener-Wilmot Hydro Inc.

STATEMENT OF RETAINED EARNINGS

For the year ended December 31st

	2004 **$**	2003 $
Retained earnings, beginning of year	**11,449,841**	7,382,142
Net Income	**3,889,527**	4,067,699
Dividend paid out (note 23)	(**542,005)**	-
Retained earnings, end of year	**14,797,363**	11,449,841

See accompanying notes

Kitchener-Wilmot Hydro Inc.

STATEMENT OF OPERATIONS

For the year ended December 31st

	2004 $	2003 $
REVENUE		
Sales Revenue		
Distribution services revenue	**29,363,383**	29,792,692
Electricity sales	**100,523,367**	101,927,448
Wholesale market services	**12,451,334**	12,343,209
Transmission services	**14,351,393**	14,452,040
Retailer services	**67,607**	76,250
	156,757,084	158,591,639
Other revenue		
Investment income	**1,241,270**	523,597
Late payment penalties	**180,040**	201,756
Miscellaneous revenue (note 14)	**788,029**	822,118
	2,209,339	1,547,471
Total revenue	**158,966,423**	160,139,110
EXPENSES		
Electricity purchases	**100,523,367**	101,927,448
Wholesale market services	**12,451,334**	12,343,209
Transmission services	**14,351,393**	14,452,040
Retailer services	**67,607**	76,250
Distribution operations	**2,315,938**	2,299,963
Distribution maintenance	**2,736,940**	2,854,332
General administration	**2,323,924**	2,316,149
Customer accounts	**2,341,230**	2,158,237
Community relations	**308,790**	311,082
Property and capital taxes	**1,006,150**	972,486
Amortization (note 15)	**8,045,955**	7,510,231
Total expenses	**146,472,628**	147,221,427
Income before interest and provision for payments-in-lieu of corporate income taxes	**12,493,795**	12,917,683
Interest expense	**5,581,825**	5,530,672
Income before provision for payments-in-lieu of corporate income taxes	**6,911,970**	7,387,011
Provision for payments-in-lieu of corporate income taxes (note 16)	**3,022,443**	3,319,312
NET INCOME	**3,889,527**	4,067,699

See accompanying notes

Kitchener-Wilmot Hydro Inc.

STATEMENT OF CASH FLOWS

For the year ended December 31st

	2004 $	2003 $
OPERATING ACTIVITIES		
Net Income	**3,889,527**	4,067,699
Add (deduct) charges to operations not requiring a current cash payment:		
(Gain) on disposal of capital assets	**(35,377)**	(20,123)
Amortization (note 15)	**8,562,155**	8,034,173
Increase in post-employment benefits obligation (note 12)	**220,616**	324,840
(Decrease) increase in non-current customer deposits	**(57,056)**	697,096
Net change in non-cash operating working capital (note 17)	**(2,613,684)**	(277,938)
Cash provided by operating activities	**9,966,181**	12,825,747
INVESTING ACTIVITIES		
(Additions) to capital assets	**(16,543,655)**	(12,959,980)
Decrease in regulatory assets / liabilities	**3,070,625**	2,846,286
Proceeds on disposals of capital assets	**35,454**	24,064
Cash (applied to) investing activities	**(13,437,576)**	(10,089,630)
FINANCING ACTIVITIES		
Increase in contributed capital	**3,622,128**	4,250,968
Dividends paid out (note 23)	**(542,005)**	-
Cash provided by financing activities	**3,080,123**	4,250,968
Net cash (applied) provided during the year	**(391,272)**	6,987,085
Cash and cash equivalents, beginning of year	**25,779,810**	18,792,725
Cash and cash equivalents, end of year	**25,388,538**	25,779,810
Cash and cash equivalents is represented by:		
Cash	**1,888,538**	279,810
Cash equivalents	**23,500,000**	25,500,000
	25,388,538	25,779,810
Supplemental cash flow information		
Interest paid	**5,538,676**	5,435,473
Payments-in-lieu of corporate income taxes and capital taxes	**3,414,883**	3,642,734

See accompanying notes

1. INCORPORATION

Kitchener-Wilmot Hydro Inc. [the Company] is a regulated electricity distribution company incorporated under the Business Corporation Act (Ontario) on July 1, 2000. The incorporation was required in accordance with the provincial government's Energy Competition Act (Bill 35). The Company is wholly owned by Kitchener Power Corporation whose shareholders are the City of Kitchener and the Township of Wilmot.

These municipalities both passed by-laws which transferred the net assets of the former Hydro-Electric Commission of Kitchener-Wilmot to the new Company on August 1, 2000. Certain surplus property assets and cash funds were excluded from the transfer and were retained by the City and the Township.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ["GAAP"] including accounting principles prescribed by the Ontario Energy Board [the "OEB"] in the Accounting Procedures Handbook [the "AP Handbook"] for Electric Distribution Utilities, and reflect the significant accounting policies as summarized below:

[a] Rate regulation

Kitchener-Wilmot Hydro Inc. is regulated by the Ontario Energy Board under the authority of the Ontario Energy Board Act, 1998. The OEB is charged with the responsibility of approving or fixing rates for the transmission and distribution of electricity, providing continued rate protection for rural and remote electricity customers, and for ensuring the distribution companies fulfill obligations to connect and service customers.

The economic impact of rate regulation is reported in these financial statements. Regulatory assets represent certain costs that may be recovered from customers in future periods through the rate-making process. In its capacity to approve or fix rates, the OEB has specified the following regulatory treatments, which have resulted in accounting treatments that differ from GAAP for enterprises operating in a non-regulated environment:

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[a] Rate regulation (continued)

[i] Transition costs

Capital and operating costs incurred in respect of the transition to competitive electricity markets in Ontario [transition costs or market ready costs] have been deferred in accordance with the criteria set in the OEB's Electricity Distribution Rate Handbook and the AP Handbook. Under such regulation, certain costs are allowed to be deferred that would be expensed when incurred under GAAP. To the extent that transition costs have been incurred which do not qualify for deferral, these costs have been expensed during the period they were incurred.

[ii] Pre-market opening energy variance

At December 31, 2002, the Company recognized the pre-market opening energy variance [the "variance"] for the period January 1, 2001 to April 30, 2002, the date of market opening [notes 3 and 8], in accordance with the AP Handbook. The variance represents the difference between the utility's cost of power purchased based on time-of-use ["TOU"] rates, and the amounts billed for the cost of power to non-TOU customers at an average rate for the same period.

[iii] Settlement variances

The Company has deferred certain post-market opening retail settlement variances in accordance with Article 490 set out in the AP Handbook. The settlement variances relates primarily to service charges, non-competitive electricity charges, and power charges (note 8). Other than the variance for the cost of imported power, the nature of the settlement variances is such that their balance shall change each reporting period-end date.

[iv] Conservation and demand management costs

Conservation and demand management [CDM] program costs incurred during 2004 have been deferred in accordance to the OEB's Procedural Order No. 1 and the AP Handbook. These costs are expected to be recovered through rates starting in 2005 upon OEB approval of the Company's CDM plan filed with the Board in January 2005. Provincial regulations allow electricity distribution companies to apply to the OEB to adjust its distribution rates in 2005 for its approved third instalment of its market adjusted revenue requirement [MARR]. OEB approval in regard to this final MARR instalment is conditional on investing an amount equal to one year's incremental returns in conservation and demand management initiatives, by no later than September 30, 2007. The Company's final incremental MARR amounts to $2,340,264.

[v] OEB incremental cost assessments

OEB costs which have been assessed to the Company in 2004, and which are incremental to amounts already included in the Company's rates, have been deferred in accordance with the AP Handbook. It is expected these costs will be recovered in rates beginning in 2006. To the extent that OEB cost assessments have been incurred which do not qualify for deferral, these costs have been expensed during the period they were incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[b] Cash and cash equivalents

Cash equivalents are readily convertible investments with maturities of three months or less from their date of acquisition. Investments are carried at costs, which approximates market value.

[c] Inventories

Inventories consist of parts, supplies and material held for the future capital expansion and are valued at the lower of average weighted cost and net realizable value.

[d] Spare transformers and meters

Spare transformers and meters are classified as capital assets in accordance with guidance in the CICA Handbook.

[e] Capital assets and amortization

Capital assets are valued at cost. Costs for assets installed or erected by the Company include material, labour and overhead.

Amortization is provided on a straight-line basis for capital assets available for use over their estimated service lives, at the following annual rates:

Buildings	2%
Transformer station equipment	2.5%
Distribution station equipment	3.33%
Distribution system	4%
Meters	4%
SCADA equipment	6.67%
Other capital assets	10 – 25%

Amortization on general equipment directly used in the installation of other capital assets, is capitalized to the new assets based on a pro-ration of the time during the year they are used for such purposes.

Full amortization is recorded in the year of acquisition and none in the year of disposal, except for readily identified assets, which are amortized on a monthly basis.

For readily identifiable assets retired or disposed of, the asset and related accumulated amortization are removed from the records. Differences between the proceeds, if any, and the unamortized asset amount plus removal costs are recorded as a gain or loss in the year of disposal.

For grouped assets, the assets and accumulated amortization are removed from the records at the end of their estimated average service life, regardless of actual service life.

[f] Construction in progress

Capital assets under construction at year-end are referred to as construction in progress and disclosed as a component of capital assets. Construction in progress is recognized as a capital asset and amortized when the asset is either put into service or construction is substantially completed.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[g] Computer software

The acquisition costs of major computer software systems are amortized by the straight-line method at an annual rate of 20%, which approximates their estimated useful lives.

[h] Contributed capital

Prior to January 1, 2000, contractor's capital contributions toward the construction or acquisition of capital assets by the Company were referred to as miscellaneous paid-in capital and disclosed as a permanent component of utility equity.

Effective May 1, 2000, the Company prospectively adopted the change in accounting policy for contributions received in aid of construction [contributed capital], as prescribed by the OEB "Accounting Procedures Handbook for Electric Distribution Utilities". Contributed capital contributions are required contributions received from outside sources, used to finance additions to capital assets. Contributed capital contributions received are treated as a "credit" contra account included in the determination of capital assets. The amount is subsequently amortized by a charge to accumulated amortization and a credit to amortization expense, at an equivalent rate to that used for the amortization of the related capital assets.

[i] Revenue recognition and cost of electrical energy

The Company records revenue from the sale of energy on the basis of regular meter readings and estimates of customer usage since the last meter reading to the end of the year. The cost of power is recognized when the energy is consumed.

[j] Pension plan

Kitchener-Wilmot Hydro Inc. provides a pension plan for its employees through the Ontario Municipal Employees Retirement System ["OMERS"]. OMERS is a multi-employer pension plan, which operates as the Ontario Municipal Employees Retirement Fund [the "Fund"] and provides pensions for employees of Ontario municipalities, local boards, public utilities, and school boards. The fund is a contributory defined benefit pension plan, which is financed by equal contributions from participating employers and employees, and by the investment earnings of the Fund. The Company recognizes the expense related to this plan as contributions are made.

[k] Post-employment benefits

Employee future benefits provided by Kitchener-Wilmot Hydro Inc. include medical and life insurance benefits. These plans provide benefits to certain employees when they are no longer providing active service. Employee future benefit expense is recognized in the period in which the employees render the services.

Employee future benefits are recorded on an accrual basis. The accrued benefit obligations and current service cost are calculated using the projected benefits method pro-rated on service and based on assumptions that reflect management's best estimate. The current service cost for a period is equal to the actuarial present value of benefits attributed to employees' services rendered in the period. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. Actuarial gains (losses) are expensed during the period in which the gains (losses) become known.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[l] Customer deposits

Customer deposits are cash collections from customers to guarantee the payment of energy bills. Deposits expected to be refunded to customers within the next fiscal year are classified as a current liability.

[m] Use of estimates

The preparation of financial statements, in conformance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that effect 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 revenue and expenses for the year. Actual results could differ from those estimates including changes as a result of future decisions made by the OEB, Minister of Energy, or the Minister of Finance.

[n] Payments-in-lieu of corporate income taxes and capital taxes

The current tax-exempt status of the Company under the Income Tax Act (Canada) and the Corporations Tax Act (Ontario) reflects the fact that the Company is wholly owned by municipalities. This tax-exempt status might be lost in a number of circumstances, including if the municipality ceases to own 90% or more of the shares or capital of the Company, or if a non-government entity has rights immediately or in the future, either absolutely or contingently, to acquire more than 10% of the shares of the Company.

Commencing October 1, 2001, the Company is required, under the Electricity Act 1998, to make payments-in-lieu of corporate taxes to Ontario Electricity Financial Corporation, which will be used to repay the stranded debt incurred by the former Ontario Hydro. 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.

As a result of becoming subject to payments-in-lieu of corporate income taxes ["PILs"], the Company's taxation year was deemed to have ended immediately beforehand and a new taxation year was deemed to have commenced immediately thereafter. The Company was therefore deemed to have disposed of each of its assets at their then fair market value and to have reacquired such assets at that same amount for purposes of computing its future income subject to PILs. For purposes of certain provisions, the Company was deemed to have a new company and, as a result, tax credits or tax losses not previously utilized by the Company would not be available to it after the change in tax status. Essentially, the Company was taxed as though it had a "fresh start" at the time of its change in tax status.

The Company provides for PILs relating to its regulated business using the taxes payable method as allowed by the OEB. Under the taxes payable method, no provisions are booked for temporary differences between the tax basis of assets and liabilities and their carrying amounts for accounting purposes. When unrecorded future income taxes, as a result of temporary differences between tax basis and accounting purposes become payable, they will be charged to the statement of operations at that time.

3. ELECTRICITY INDUSTRY RESTRUCTURING AND REGULATION

On October 30, 1998, the provincial government passed the Electricity Act and the Ontario Energy Board Act, collectively known as Bill 35, the Energy Competition Act, 1998. The Electricity Act established the framework for a competitive market for the sale of electricity in the Province of Ontario. The Ontario Energy Board Act gave the Ontario Energy Board [OEB] the power to licence and regulate all market participants, and set transmission and distribution rates.

The electricity marketplace was deregulated on May 1, 2002 and electricity generators, electricity wholesalers and retailers began competing for customers. As mandated by the Energy Competition Act [Bill 35], a three-year phase-in (2001 to 2003) of the electricity distributors' commercial rate of return and provincial tax increases was implemented to smooth the impact on consumers of the transition of distributors from municipal electric utilities.

However, in response to volatile and rising electricity prices in 2002, the Province of Ontario enacted The Electricity Pricing, Conservation and Supply Act, 2002 [Bill 210]. This new legislation was given Royal Assent on December 9, 2002 which effectively froze distribution rates until 2006, and fixed the commodity price paid by low volume and designated customers at 4.3 cents per kilowatt-hour [kWh] retroactive May 1, 2002.

On December 18, 2003, Bill 210 was superseded and modified by Bill 4 when a newly elected provincial government passed the Ontario Energy Board Amendment Act (Electricity Pricing), 2003 which enabled further changes to the pricing of electricity in Ontario.

In June 2004, the provincial government introduced legislation to further restructure the electricity industry. On December 9, 2004, this new legislation, the Electricity Restructuring Act, 2004 [Bill 100] received Royal Assent. Bill 100 makes amendments to the Electricity Act, and the Ontario Energy Board Act, 1998. The legislation deals primarily with supply and conservation, reassigns responsibilities to different entities, and lays out the roles and responsibilities for the new Ontario Power Authority (OPA). Additionally, the Independent Market Operation (IMO) will be renamed the Independent Electricity System Operator (IESO) to better reflect its new role.

[i] Electricity commodity pricing

On April 1, 2004, Bill 4 removed the 4.3 cents commodity price freeze, and a two-tiered pricing regime was implemented for all customers who were eligible for the 4.3 cents commodity rate. The commodity price was fixed at 4.7 cents per kWh for the first 750 kWh of consumption per month and 5.5 cents per kWh for any incremental monthly consumption thereafter. This current two-tiered pricing regime will remain in place until April 1, 2005 when the OEB will institute a regulated price plan [RPP].

The proposed RPP will retain the two-tiered pricing regime, but the 750 kWh threshold for residential customers will only stay in place until October 31, 2005. Thereafter, the proposed thresholds for residential consumers are 1000 kWh during a winter season (November 1 to April 30) and 600 kWh during a summer season (May 1 to October 31). For non-residential consumers, the 750 kWh threshold will remain the same throughout the year. The RPP also proposes time-of-use pricing for consumers installed with smart meters.

3. ELECTRICITY INDUSTRY RESTRUCTURING AND REGULATION (CONTINUED)

[ii] Recovery of regulatory assets

Bill 210 eliminated the ability of electricity distributors to recover a variety of costs incurred since their preparations for market opening. These costs were deemed to be "regulatory assets", and are reflected in the balance sheet until the manner and timing of disposition is determined by the OEB.

With the introduction of Bill 4, the Company was allowed to recover some of its regulatory assets under the supervision of the OEB, on an interim basis, over a four-year period starting April 1, 2004 (note 8). In light of the four-year time span coupled with uncertainty and associated political risks, management has recorded a reserve for regulatory asset impairment in the amount of $3,444,911. This represents the pre-market opening energy variance of $3,033,473 and the transition costs of $411,438 incurred to meet the requirements of market readiness.

On December 9, 2004, the OEB released its process for OEB review of the prudence of the total regulatory asset amounts claimed by electricity distributors. This process, which commences in 2005, will determine the final recovery amount of their regulatory assets to be included in future distribution rates.

[iii] Recovery of the third instalment of market adjusted revenue requirement [MARR]

Bill 4 also allows electricity distributors to adjust their distribution rates starting March 1, 2005 to achieve their full commercial rate of return conditional on LDCs reinvesting the equivalent of one year of these monies in conservation and demand management initiatives. The Company filed its Conservation and Demand Management Plan with the OEB in January 2005. The maximum rate of return, which had been set by the OEB before Bill 210 was 9.88%.

4. ACCOUNTS RECEIVABLE

	2004 $	2003 $
Electrical energy	**11,332,288**	11,188,213
Miscellaneous	**2,977,092**	1,450,243
	14,309,380	12,638,456
Less: Allowance for doubtful accounts	**(325,000)**	(325,000)
	13,984,380	12,313,456

5. RELATED PARTY TRANSACTIONS

The Company conducted the following transactions with related parties during the year ended December 31, 2004. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

	2004 $	2003 $
Fibretech Telecommunications Inc. – construction, engineering and operation services	**318,745**	290,079
City of Kitchener – capital and maintenance street light services	**518,261**	450,906
Township of Wilmot – capital and maintenance street light services	**9,914**	52,003

At year-end, the related party balances are as follows:

	2004 $	2003 $
Receivable from Fibretech Telecommunications Inc.	**11,358**	3,965
Receivable from City of Kitchener	**120,434**	464,253
Receivable from Township of Wilmot	**1,946**	28,345
	133,738	496,563

6. CAPITAL ASSETS – NET OF ACCUMULATED AMORTIZATION

2004	**Cost**	**Accumulated Amortization**	**Net Book Value**
	$	**$**	**$**
Land	**3,527,347**	**-**	**3,527,347**
Land rights	**261,699**	**234,149**	**27,550**
Buildings	**14,590,879**	**3,338,236**	**11,252,643**
Transformer station equipment	**35,768,199**	**9,969,220**	**25,798,979**
Distribution station equipment	**2,759,055**	**1,411,055**	**1,348,000**
Distribution system – conductors and devices	**126,360,361**	**56,425,790**	**69,934,571**
Distribution system – line and network transformers	**38,076,020**	**16,786,277**	**21,289,743**
Meters	**9,878,861**	**4,238,905**	**5,639,956**
SCADA – system supervisory equipment	**1,928,386**	**1,292,334**	**636,052**
Other capital assets	**10,828,564**	**7,608,697**	**3,219,867**
Construction in progress	**1,303,769**	**-**	**1,303,769**
	245,283,140	**101,304,663**	**143,978,477**
Less: Contributed capital	**(16,627,062)**	**(1,872,719)**	**(14,754,343)**
	228,656,078	**99,431,944**	**129,224,134**

2003	Cost	Accumulated Amortization	Net Book Value
	$	$	$
Land	2,698,307	-	2,698,307
Land rights	261,699	231,646	30,053
Buildings	13,068,057	3,073,394	9,994,663
Transformer station equipment	31,879,137	9,070,417	22,808,720
Distribution station equipment	2,759,055	1,317,786	1,441,269
Distribution system – conductors and devices	118,969,119	52,082,619	66,886,500
Distribution system – line and network transformers	36,270,685	15,286,233	20,984,452
Meters	9,482,610	3,856,090	5,626,520
SCADA – system supervisory equipment	1,890,607	1,204,928	685,679
Other capital assets	10,867,774	7,343,666	3,524,108
Construction in progress	2,029,442	-	2,029,442
	230,176,492	93,466,779	136,709,713
Less: Contributed capital	(13,004,934)	(1,207,636)	(11,797,298)
	217,171,558	92,259,143	124,912,415

7. COMPUTER SOFTWARE – NET OF ACCUMULATED AMORTIZATION

2004	**Cost**	**Accumulated Amortization**	**Net Book Value**
	$	**$**	**$**
Financial system software	**572,225**	**489,746**	**82,479**
Supervisory control software	**60,620**	**58,203**	**2,417**
Meter interrogation software	**61,071**	**57,814**	**3,257**
Computer aided design system software	**352,854**	**273,132**	**79,722**
Network software	**287,926**	**79,560**	**208,366**
Human resources software	**106,316**	**13,879**	**92,437**
	1,441,012	**972,334**	**468,678**

2003	Cost	Accumulated Amortization	Net Book Value
	$	$	$
Financial system software	551,237	391,266	159,971
Supervisory control software	60,620	50,529	10,091
Meter interrogation software	61,071	47,101	13,970
Computer aided design system software	338,014	204,513	133,501
Network software	91,017	28,777	62,240
Human resources software	42,362	1,033	41,329
	1,144,321	723,219	421,102

8. REGULATORY ASSETS & LIABILITIES

The “Electricity Pricing, Conservation and Supply Act, 2002” [Bill 210] deems certain costs and variance account balances to be accounted for as regulatory assets [note 2(a)].

The Ontario Energy Board Amendment Act, (Electricity Pricing), 2003 [Bill 4] allowed LDCs to adjust their distribution rates to recover some of its regulatory assets, on an interim basis, over a four year period starting April 1, 2004.

On December 9, 2004 the OEB released its process for OEB review of the prudence of the total regulatory asset amounts claimed by electricity distributors. This process, which commences in 2005, will determine the final recovery amount of their regulatory assets to be included in future distribution rates.

Also on December 9, 2004, the OEB explicitly authorized the recording of interest if the deferral accounts are considered to be long term in nature, generally more than one year. As a result of this decision in 2004, the Company recorded interest in the amount of $600,265.10 [2003 – Nil] pertaining to the pre-market opening energy variance and retail service cost variances.

8. REGULATORY ASSETS & LIABILITIES (CONTINUED)

[i] Regulatory assets consist of the following:

	2004 $	2003 $
Current portion of regulatory assets:		
Bill 210 rebate program costs	**15,973**	-
Pre-market opening energy variance	**478,243**	-
Retail cost variances	**3,065**	-
Retail settlement variances	**407,665**	-
Transition costs	**62,189**	-
	967,135	-
Long-term portion of regulatory assets:		
Bill 210 rebate program costs	**97,696**	99,708
Conservation and demand management expenditures	**19,000**	-
Pre-market opening energy variance	**3,150,786**	3,033,474
Retail service cost variances	**66,138**	37,384
Retail settlement variances	**2,470,108**	2,450,920
Transition costs	**357,466**	439,463
Other regulatory assets	**95,514**	-
	6,256,708	6,060,949
Less: Regulatory assets recovered	**(1,279,465)**	-
	4,977,243	6,060,949
Total regulatory assets	**5,944,378**	6,060,949

[ii] Regulatory liabilities consist of the following:

	2004 $	2003 $
Current portion of regulatory liabilities:		
Prudential deposits	**28,993**	-
Retail settlement variances	**310,757**	-
	339,750	-
Long-term portion of regulatory liabilities:		
Prudential deposits	**139,106**	372,098
Retail cost variances	**2,772**	-
Retail settlement variances	**5,540,012**	3,322,873
	5,681,890	3,694,971
Total regulatory liabilities	**6,021,640**	3,694,971

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2004 $	2003 $
Independent Electricity Market Operator	**12,557,704**	11,664,093
Ontario Electricity Financial Corporation	**927,472**	968,370
Provincial Bill 210, MPMA, BPPR rebates	**167**	26,569
Other	**2,654,478**	3,438,080
	16,139,821	16,097,112

10. LONG-TERM DEBT

[i] Effective August 1, 2000, Kitchener-Wilmot Hydro Inc. incurred unsecured promissory notes payable to the City of Kitchener and to the Township of Wilmot. The amounts due at the end of the year are:

	2004 $	2003 $
City of Kitchener	**70,997,576**	70,997,576
Township of Wilmot	**5,964,566**	5,964,566
	76,962,142	76,962,142

[ii] Interest is payable annually at an annual effective rate of 7% for the year 2004 and the OEB deemed rate (currently 7%) each year thereafter. Repayment of all or part of the outstanding principal may be made upon eighteen months written notice. The Company paid the following interest:

	2004 $	2003 $
City of Kitchener	**4,983,446**	4,969,830
Township of Wilmot	**418,664**	417,520
	5,402,110	5,387,350

11. PENSION PLAN

Effective August 1, 1998, OMERS provided a temporary contribution holiday, with no Company or employee pension contributions required until after December 31, 2002. In January 2003, OMERS contributions resumed at reduced rates and in January 2004, returned to full levels at higher rates than before the contribution holiday.

	2004 $	2003 $
Service pension costs	**626,881**	197,604

12. POST-EMPLOYMENT BENEFITS

Kitchener-Wilmot Hydro Inc. pays certain health, dental and life insurance benefits on behalf of its retired employees.

The significant actuarial assumptions adopted in measuring the accrued benefit obligations are as follows:

	2004	2003
	%	%
Discount rate	**5.0**	5.5
Future general salary and wage levels increase	**3.5**	3.5
Future general inflation increase	**2.2**	2.2
Dental costs increase	**CPI rate plus a further 3.4% increase in 2004, graded down to 1.65% in 2009 and thereafter**	CPI rate plus a further 3.75% increase in 2003, graded down to 1.3% in 2010 and thereafter
Medical costs increase	**CPI rate plus a further 10.8% increase in 2004, graded down to 8.3% in 2009 and thereafter**	CPI rate plus a further 11.3% increase in 2003, graded down to 7.8% in 2010 and thereafter

Information about Kitchener-Wilmot Hydro Inc.'s defined benefits plans is as follows:

	2004	2003
	$	$
Accrued benefit obligation		
Balance, beginning of the year	**4,392,363**	4,067,523
Benefit cost for the year	**386,140**	472,108
Benefits paid for the year	**(165,524)**	(147,268)
Projected accrued benefit obligation at December 31 as determined by actuarial valuation	**4,612,979**	4,392,363

13. SHARE CAPITAL

	2004	2003
	$	$
Authorized		
Unlimited common shares		
Issued		
10,000 common shares	**63,689,499**	63,689,499

14. MISCELLANEOUS REVENUE

	2004	2003
	$	$
Pole attachment rentals, building and other rentals	**448,771**	482,826
Change of occupancy charges	**142,749**	135,601
Scrap sales	**27,580**	33,871
Net gain on disposal of capital assets	**35,377**	20,123
Unsealing / reconnection charges	**18,731**	14,550
Accounts payable discounts taken	**31,142**	22,057
Return cheque charges	**12,592**	13,525
Sundry	**71,087**	99,565
	788,029	822,118

15. AMORTIZATION

	2004	2003
	$	$
Amortization	**8,045,955**	7,510,231
Various expense accounts	**516,200**	523,942
	8,562,155	8,034,173

16. CORPORATE INCOME AND CAPITAL TAXES

The provision for PILs differs from the amount that would have been recorded using the combined Canadian Federal and Ontario statutory income tax rate. Reconciliation between the statutory and effective tax rates is provided as follows:

[i] Statement of Operations

	2004 $	2003 $
Rate reconciliation:		
Income from continuing operations before income taxes	**6,911,970**	7,387,011
Statutory Canadian Federal and Provincial income tax rate	**36.12%**	36.62%
Expected taxes on income	**2,496,604**	2,705,124
Other permanent differences	**5,940**	5,780
Increase (decrease) in income taxes resulting from:		
Large corporations tax net of surtax	**143,856**	251,052
Other current year timing differences not benefited	**387,071**	296,270
Dividend refund	**(180,668)**	-
Increase tax on investment income	**169,640**	61,086
Income tax expense	**3,022,443**	3,319,312
Effective tax rate	**43.73%**	44.93%
Components of income tax expense:		
Current tax expense, including large corporations tax	**3,022,443**	3,319,312
Income tax expense	**3,022,443**	3,319,312

[ii] Balance Sheet

Future income taxes relating to the regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2004, future income tax assets of $10,547,203 [2003 - $9,417,796], based on substantively enacted income tax rates have not been recorded.

17. NET CHANGE IN NON-CASH OPERATING WORKING CAPITAL

	2004 $	2003 $
(Increase) decrease in accounts receivable	**(1,308,099)**	4,392,556
(Increase) in unbilled accounts receivable	**(1,497,400)**	(272,200)
(Increase) in inventories	**(301,834)**	(38,862)
Decrease (increase) in prepaid and accrued interest receivable	**66,297**	(27,764)
(Increase) in current portion of regulatory assets	**(967,135)**	-
Increase (decrease) in accounts payable and accrued liabilities	**10,606**	(4,318,362)
Increase in current portion of customer deposits	**714,400**	697,000
Increase (decrease) in construction and property deposits	**329,731**	(710,306)
Increase in current portion of regulatory liabilities	**339,750**	-
	(2,613,684)	(277,938)

18. CREDIT RISK AND FINANCIAL INSTRUMENTS

[i] Credit risk

For distribution retail customers, credit losses are generally low across the sector. The Company provides for an allowance for doubtful accounts to absorb credit losses. At December 31, 2004, there are no significant concentrations of credit risk with respect to any class of financial assets.

[ii] Fair value of financial instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and promissory notes payable approximates their fair value due to the immediate or short-term maturity of these financial instruments.

19. INVENTORIES

Inventories consist of:

	2004 $	2003 $
Stores	**2,191,251**	1,717,330
Transformers	**489,936**	660,049
Meters	**48,852**	50,826
	2,730,039	2,428,205

20. PRUDENTIAL SUPPORT OBLIGATION

Kitchener-Wilmot Hydro Inc. purchases power from the Independent Electricity System Operator [IESO] on behalf of its customers and retailers. The IESO [formerly IMO] is responsible for ensuring that prudential support is posted by all market participants to mitigate the impact of an event of default by a market participant on the rest of the market. In this regard, at December 31, 2004, Kitchener-Wilmot Hydro Inc. has posted an irrevocable standby letter of credit as security in the amount of $25,558,870 [2003 - $25,558,870] underwritten by the Company's principal bank. The Company has entered into a credit facility agreement with its bank in which contains certain financial covenants.

21. CONTINGENT LIABILITY

[i] A class action lawsuit claiming $500 million in restitution payments plus interest was served on Toronto Hydro on November 18, 1998. The action was initiated against Toronto Hydro Electric Commission as the representative of the Defendant Class consisting of all municipal electric utilities in Ontario, which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim in that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per year, which is illegal under Section 347(1)(b) of the Criminal Code.

The Electricity Distribution Association [EDA] is undertaking the defence of this class action.

On April 24, 2004 the Supreme Court of Canada rendered its judgement against Enbridge Gas Distribution Inc., ruling that the late payment penalties that the natural gas utility had charged customers from 1994 to 2002 exceeded legal limit. Counsel of the OEB, which regulates electricity and natural gas distributors, as well as EDA's lawyers are reviewing the ruling to determine the implications, if any, on the class action of November 18, 1998 against all municipal electric utilities in Ontario.

At this time, it is not possible to quantify the effect, if any, on the financial statements of the Company.

[ii] In 2004, Kitchener-Wilmot Hydro Inc. was successful in defending a lawsuit with respect to the issue of security deposits. A new large volume customer claimed that the security deposit required by the Company was a penalty and unenforceable. On October 20, 2004, the Ontario Court of Justice issued a judgement dismissing all claims against the Company and further declared the Company's entitlement of a security deposit from the plaintiff, as well as the right to terminate service for non-payment of such deposit.

An appeal has subsequently been filed by the plaintiff. At this time, it is not possible to quantify the effect, if any, of the pending appeal on the financial statements of the Company.

22. GENERAL LIABILITY INSURANCE

The Company is a member of the Municipal Electric Association Reciprocal Insurance Exchange [MEARIE], which is a pooling of general liability insurance risks. Members of MEARIE would be assessed on a pro-rata basis should losses be experienced by MEARIE, for the years in which the Company was a member. To December 31, 2004, the Company has not been made aware of any additional assessments.

23. DIVIDENDS

Dividends in the amount of $542,005 [2003 - NIL] were declared and paid to Kitchener Power Corporation in 2004. The Company is in compliance with its covenants contained in the Company's credit facility agreement with its bank pertaining to the payment of dividends.

24. COMPARATIVE FIGURES

Certain of the prior year comparative figures have been restated to conform to the current year's presentation.

SUPPLEMENTARY FINANCIAL STATEMENTS

KITCHENER-WILMOT HYDRO INC.

January 1 – December 31, 2004

KPMG

KPMG LLP
Chartered Accountants
20 Erb Street West
Marsland Centre 3rd Floor
Waterloo ON N2L 1T2

Telephone (519) 747-8800
Fax (519) 747-8830
Internet www.kpmg.ca

AUDITORS' REPORT ON SUPPLEMENTARY FINANCIAL INFORMATION

Kitchener-Wilmot Hydro Inc.

We have audited and reported separately herein on the financial statements of Kitchener-Wilmot Hydro Inc. as at and for the year ended December 31, 2004

Our audit was conducted for the purposes of forming an opinion on the basic financial statements of the Company taken as a whole. The supplementary information included in the Supplementary Financial Statements is prepared for the purposes of additional analysis and is not a required part of the basic financial statements. Such supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

Chartered Accountants

Waterloo, Canada
February 25, 2005

YEAR IN BRIEF

For the year ended December 31st

	2004	2003
Financial Highlights		
Total revenue	**$158,966,423**	$160,139,110
Total expenses	**$155,076,896**	$156,071,411
Net income	**$3,889,527**	$4,067,699
Additions to capital assets	**$16,543,655**	$12,959,980
Net capital assets	**$129,224,134**	$124,912,415
Long-term debt	**$76,962,142**	$76,962,142
Shareholders' equity	**$78,486,862**	$75,139,340
Rate of return on net capital assets	**6.3%**	6.7%
Debt to equity ratio	**49.5%**	50.6%
Current ratio	**2.58**	2.58

Customer Data

	2004	2003
Number of customers	**77,283**	75,269
Number of employees	**167**	166
Kilowatt hour sales	**1,999,939,117**	2,023,071,898
Kilowatts purchased	**3,717,361**	3,735,369
Kilowatt peak demand	**344,351**	357,759

Performance Indicators

	2004	2003
Controllable expenses per customer	**$129.74**	$132.06
Average monthly system load factor	**73.1%**	73.3%

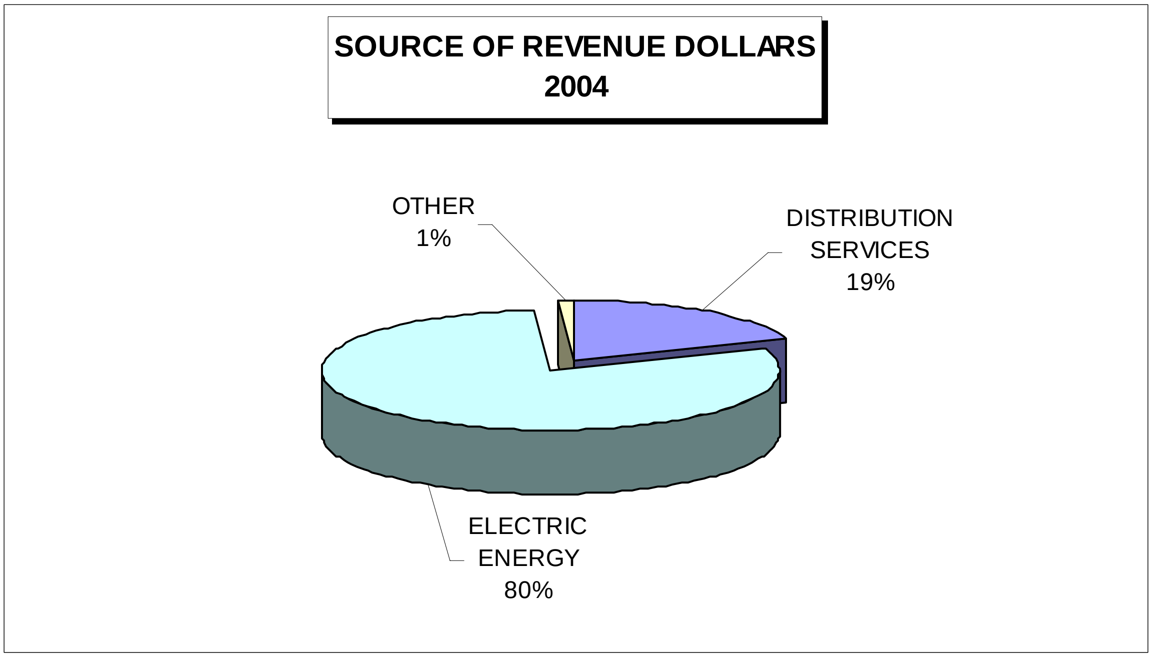
	OEB Standard %	**Annual % met within minimum standards %**	Annual % met within minimum standards %
Connection of new services – low voltage	90.0	**88**	92
Connection of new services – high voltage	90.0	**100**	100
Underground cable locates	90.0	**100**	100
Telephone accessibility	65.0	**74**	74
Appointments met	90.0	**95**	94
Written responses to inquiries	80.0	**97**	100
Emergency response – urban areas	80.0	**98**	96
Emergency response – rural areas	80.0	**100**	100

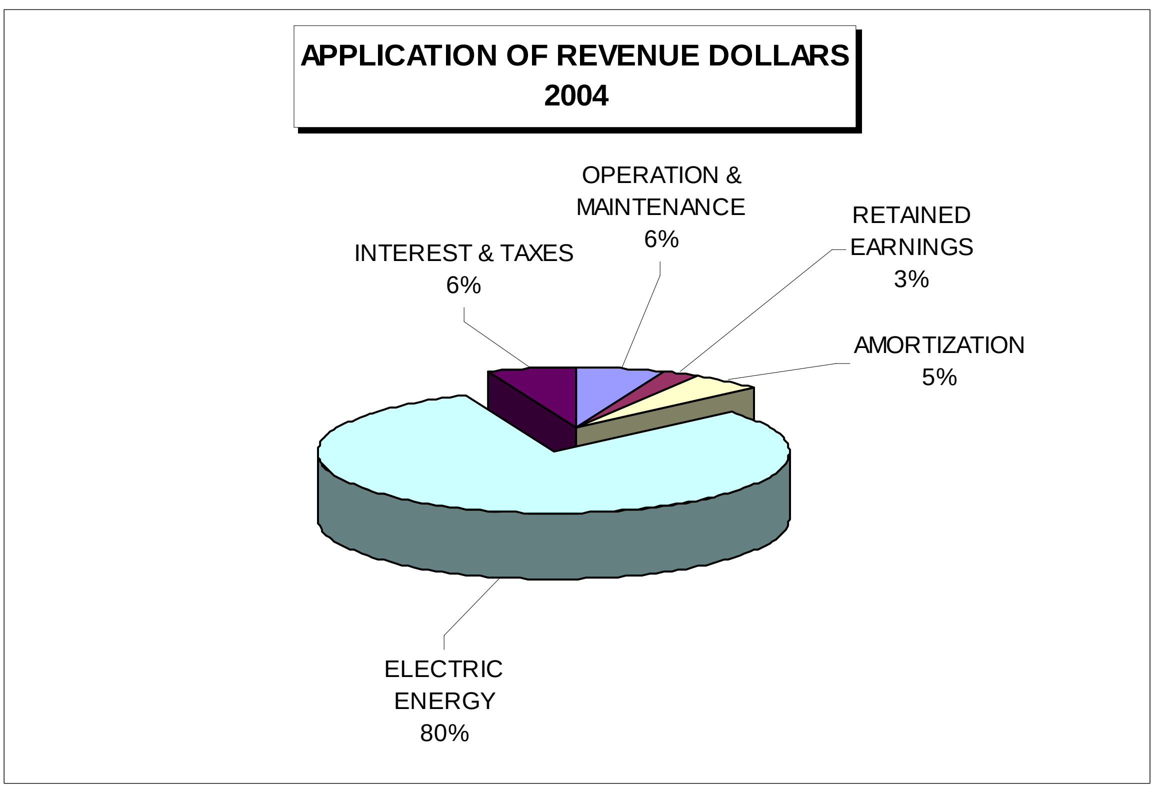
Service Reliability Indices

	2004	2003
System average interruption duration (minutes)	**32.2**	57.8
System average interruption frequency index (average number of interruptions per customer)	**0.51**	1.41
Customer average interruption duration (minutes)	**63.4**	41.1

SOURCE & APPLICATIONS OF REVENUE DOLLARS

For the year ended December 31st





OPERATING STATISTICS

For the year ended December 31st

	2004	2003
Kilowatt Hours Sold		
Residential	**611,126,167**	628,458,654
General service	**1,137,365,729**	1,124,929,539
Large user	**235,982,074**	254,413,811
Street lighting	**15,465,147**	15,269,894
	1,999,939,117	2,023,071,898
Number of Customers		
Residential	**69,405**	67,527
General service	**7,874**	7,738
Large user	**4**	4
	77,283	75,269
Average monthly kilowatts	**309,780.1**	311,280.8

STATEMENT OF CAPITAL ASSETS

For the year ended December 31st

		2004 $
Land		**3,527,347**
Land Rights		**261,699**
Buildings		
Distribution and transformer stations (as per list)	**5,731,007**	
Operations centre – Victoria Street South	**8,460,417**	
Vehicle maintenance garage building	**399,455**	**14,590,879**
Equipment		
Distribution and transformer station equipment (as per list)	**37,198,883**	
Spare power transformer	**1,115,380**	
Portable mobile transformer substation	**79,664**	
Portable mobile generator	**133,327**	**38,527,254**
Distribution system – overhead conductors and devices	**48,539,285**	
Distribution system – underground conductors and devices	**77,821,076**	**126,360,361**
Distribution system – line transformers	**37,776,630**	
Distribution system – network transformers	**299,390**	**38,076,020**
Meters		**9,878,861**
SCADA – system supervisory equipment		**1,928,386**
General office equipment	**817,814**	
Computer equipment	**1,890,113**	
Computer application software	**1,441,012**	
Vehicles & equipment	**6,462,153**	
Stores warehouse equipment	**109,433**	
Major tools, instruments & radios	**1,543,111**	
Safety equipment	**5,940**	**12,269,576**
Construction in progress		**1,303,769**
Contributed capital		**(16,627,062)**
		230,097,090

Kitchener-Wilmot Hydro Inc.

STATEMENT OF TRANSFORMER STATION BUILDINGS AND EQUIPMENT

For the year ended December 31st

		2004 $ BUILDINGS	2004 $ EQUIPMENT
Distribution station # 1	New Hamburg	**110,211**	**403,613**
Distribution station # 2	New Hamburg	**31,314**	**262,291**
Distribution station # 3	New Dundee	**122,611**	**330,143**
Distribution station # 5	Josephsburg	**50,227**	**239,304**
Distribution station # 6	Baden	**109,666**	**493,728**
Distribution station # 7	New Hamburg	**144,047**	**330,439**
Distribution station # 8	Philipsburg	**156,153**	**486,545**
Transformer station # 1	West Avenue	**709,637**	**4,444,422**
Transformer station # 2	Bleams Road	**460,149**	**1,312,316**
Transformer station # 3	Bleams Road	**817,730**	**6,411,480**
Transformer station # 4	West Avenue	**156,309**	**4,010,989**
Transformer station # 5	Graber Place	**402,274**	**2,759,607**
Transformer station # 6	Ottawa Street South	**548,654**	**5,854,801**
Transformer station # 7	Fairway Road	**666,626**	**4,162,492**
Transformer station # 8	Huron Road	**1,245,399**	**5,696,713**
		5,731,007	**37,198,883**

ADDITIONS TO CAPITAL ASSETS

For the year ended December 31st

		2004 $
Land		
Motz Park		**829,040**
Buildings		
Operations centre – Victoria Street South	**1,315,350**	
Transformer station # 8	**41,285**	**1,356,635**
Transformer station equipment		
Transformer station # 1	**41,560**	
Transformer station # 8	**3,380,197**	**3,421,757**
Distribution system – conductors and devices		
Overhead	**3,000,089**	
Underground	**4,708,713**	**7,708,802**
Distribution system – line and network transformers		**1,935,334**
Meters		**396,252**
SCADA – system supervisory equipment		**37,778**
General Office equipment		**53,841**
Computer hardware		**130,715**
Computer software		**296,691**
Vehicles and equipment		**293,342**
Major tools, instruments and radios		**58,596**
Meter shop accreditation		**24,872**
		16,543,655

CHANGES IN WORKING CAPITAL COMPONENTS

For the year ended December 31st

	2004 $
Current Assets	**59,753,534**
Current Liabilities	**(23,136,764)**
Working Capital	**36,616,770**

	2004 $	2003 $	Change $
Cash and cash equivalents	**25,388,538**	25,779,810	(391,272)
Accounts receivable	**14,118,118**	12,810,019	1,308,099
Unbilled revenue receivable	**16,143,900**	14,646,500	1,497,400
Inventories	**2,730,039**	2,428,205	301,834
Prepaid expenses	**337,257**	419,889	(82,632)
Accrued interest receivable	**68,547**	52,212	16,335
Current portion of regulatory assets	**967,135**	-	967,135
Accounts payable and accrued liabilities	**(16,235,479)**	(16,224,873)	(10,606)
Current portion of customers deposits	**(2,869,400)**	(2,155,000)	(714,400)
Construction and property deposits	**(3,692,135)**	(3,362,404)	(329,731)
Current portion of regulatory liabilities	**(339,750)**	-	(339,750)
Working Capital	**36,616,770**	34,394,358	2,222,412