

FINANCIAL STATEMENTS OF
NEWMARKET HYDRO LTD.
December 31, 2006

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AUDITORS' REPORT

To the Shareholder of
Newmarket Hydro Ltd.

We have audited the balance sheet of Newmarket Hydro Ltd. as at December 31, 2006 and the statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. 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 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 company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Collins Barrow Kawarthas

Chartered Accountants
Licensed Public Accountants

Peterborough, Ontario
March 29, 2007

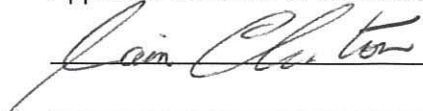
NEWMARKET HYDRO LTD.

BALANCE SHEET

As at December 31, 2006

	2006 \$	2005 \$
ASSETS		
Current assets		
Cash	7,848,156	13,635,617
Short-term investment (note 3)	805,305	412,700
Accounts receivable	6,491,636	3,722,524
Unbilled revenue	6,608,773	6,312,983
Income taxes receivable (note 4)	-	224,077
Inventory	1,140,909	773,894
Prepaid and other	249,573	217,558
	23,144,352	25,299,353
Regulatory Assets (note 5)	1,431,655	1,843,581
Property, plant and equipment (note 6)	39,954,568	38,692,094
	64,530,575	65,835,028
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 7)	7,433,381	9,561,985
Income taxes payable	238,078	-
Deferred revenue	826,528	769,969
Due to Newmarket Hydro Holdings Inc. (note 8)	233,634	1,138,958
Current portion of deposits held	352,586	352,586
	9,084,207	11,823,498
Note payable (note 9)	22,000,000	22,000,000
Deposits held	2,764,612	2,283,888
Employee future benefits (note 10)	704,943	613,643
	34,553,762	36,721,029
Shareholder's equity		
Share capital (note 11)	25,806,563	25,806,563
Retained earnings	4,170,250	3,307,436
	29,976,813	29,113,999
	64,530,575	65,835,028

Approved on behalf of the Board



Director

Director

The accompanying notes are an integral part of these financial statements

NEWMARKET HYDRO LTD.
STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31, 2006

	2006 \$	2005 \$
Sales	65,437,902	66,616,693
Cost of sales	51,068,659	53,647,628
Gross profit	14,369,243	12,969,065
Expenses		
Amortization	3,259,164	3,001,408
Administration	1,894,157	1,691,114
System operation and maintenance	1,662,771	1,718,331
Interest	1,778,121	1,709,512
Customer billing and collecting	1,284,979	1,266,615
Property and capital taxes	239,395	225,678
Donations	-	1,885,000
	10,118,587	11,497,658
Income before undernoted items and income taxes	4,250,656	1,471,407
Other income		
Interest	496,202	304,596
Occupancy, connection and collection fees	444,586	515,489
Service and retailer charges	128,718	120,627
Rental	115,932	167,008
Gain on sale of property, plant and equipment	48,271	25,700
	1,233,709	1,133,420
Income before income taxes	5,484,365	2,604,827
Provision for income taxes	2,221,551	676,606
Net income for the year	3,262,814	1,928,221
Retained earnings - beginning of year	3,307,436	1,579,215
	6,570,250	3,507,436
Dividends paid	(2,400,000)	(200,000)
Retained earnings - end of year	4,170,250	3,307,436

The accompanying notes are an integral part of these financial statements

NEWMARKET HYDRO LTD.

STATEMENT OF CASH FLOWS

For the year ended December 31, 2006

	2006 \$	2005 \$
CASH PROVIDED FROM (USED FOR)		
Operating activities		
Net income for the year	3,262,814	1,928,221
Items not affecting cash		
Amortization	3,571,475	3,362,421
Gain on sale of property, plant and equipment	(48,271)	(25,700)
Employee future benefits	91,300	99,600
	6,877,318	5,364,542
Change in non-cash working capital items (note 12)	(5,466,427)	5,171,197
	1,410,891	10,535,739
Investing activities		
Purchase of property, plant and equipment	(4,853,237)	(3,670,348)
Proceeds on disposal of property, plant and equipment	67,559	39,959
Increase (decrease) in regulatory assets	411,926	(859,005)
	(4,373,752)	(4,489,394)
Financing activities		
Due from Newmarket Hydro Holdings Inc.	(905,324)	(195,218)
Deposits held	480,724	(506,791)
Dividends paid	(2,400,000)	(200,000)
	(2,824,600)	(902,009)
Increase (decrease) in cash	(5,787,461)	5,144,336
Cash - beginning of year	13,635,617	8,491,281
Cash - end of year	7,848,156	13,635,617

The accompanying notes are an integral part of these financial statements

NEWMARKET HYDRO LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

1. NATURE OF OPERATIONS

Newmarket Hydro Ltd. (the Company) is a wholly-owned subsidiary of Newmarket Hydro Holdings Inc. and was incorporated April 10, 2000 under the Business Corporations Act of the Province of Ontario. The Company commenced operations on November 1, 2000. Newmarket Hydro Holdings Inc. is wholly-owned by the Town of Newmarket

The principal activity of the Company is to distribute electricity to the residents and businesses in the Town of Newmarket under license issued by the Ontario Energy Board (OEB). The Company is regulated by the OEB and adjustments to its distribution rates require OEB approval.

2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. The significant policies are detailed as follows:

(a) *Electricity Regulation*

The Company is subject to rate regulation by the Ontario Energy Board (OEB). The OEB is charged with the responsibility of approving rates for the transmission and distribution of electricity. The following regulatory policies are practiced in a rate regulated environment.

(i) Regulatory Assets

Regulatory assets consist of deferred qualifying transition costs and various rate and retail variance accounts. The costs related to these accounts are deferred for accounting purposes because it is probable that they will be recovered in future rates. Regulatory assets recognized at December 31, 2006 are disclosed in Note 5. The Company continually assesses the likelihood of the recovery of these assets. If recovery is no longer considered probable, the amounts are charged to operations in the year the assessment is made. The recovery of regulatory assets commenced April 1, 2004.

(ii) Corporate Taxes

Under the Electricity Act, 1998, the Company is required to make payments in lieu of income taxes (PILS) to the Ontario Electricity Financial Corporation (OEFC). As directed by the OEB, the Company provides for PILS payments using the taxes payable method. Under the taxes payable method, no provisions are made for future income taxes as a result of temporary differences between the tax basis of assets and liabilities and their carrying amounts. Additional details related to the calculation and method of accounting for PILS is included at Note 4.

NEWMARKET HYDRO LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

2. SIGNIFICANT ACCOUNTING POLICIES, continued

(b) *Management estimates*

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(c) *Short-term investments*

Short term investments are carried at the lower of cost and market value.

(d) *Inventory*

Inventory is valued at the lower of cost and net realizable value with costs being determined on a weighted average basis. Inventory consists primarily of parts and materials used for maintenance and capital projects.

(e) *Property, plant and equipment*

Property, plant and equipment are recorded at cost. The company provides for amortization using the straight-line method at rates designed to amortize the cost of the property, plant and equipment over their estimated useful lives. The annual amortization rates are as follows:

Transmission and distribution systems	25 to 30 years
Office equipment	3 to 10 years
Leasehold improvements	10 years
Plant and equipment	10 to 15 years

Contributions for capital construction consist of third party contributions toward the cost of constructing distribution assets. The third party contribution is calculated through an economic evaluation as per the OEB Distribution Service Code. Contributed capital amounts are recorded as received and amortized over the same period as the asset to which they relate being 25 to 30 years.

(f) *Financial instruments*

The estimated fair value of the Company's financial assets and liabilities approximates carrying value. Unless otherwise noted it is management's opinion that the Company is not exposed to significant interest, currency or credit risk.

The company is exposed to credit risk from customers. However, the company has a significant number of customers which minimizes concentration of credit risk.

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

2. SIGNIFICANT ACCOUNTING POLICIES, continued

(g) Deferred revenue

Deferred revenue represents amounts received from the OEB related to Conservation Demand Management funds received and not expended in the current year.

(h) Related party transactions

Related party transactions are in the normal course of operations and have been measured at the exchange amount which is the amount of consideration established and agreed to by the related parties. Details of related party transactions and balances are detailed in Note 8.

(i) Employee future benefits

The Company pays certain health, dental and life insurance benefits on behalf of its retired employees. The Company recognizes these post-retirement costs in the period in which the employees earn the benefits. The cost of employee future benefits earned by employees is actuarially determined using the projected benefit method prorated on length of service and management's best estimate of salary escalation, retirement ages of employees, employee turnover and expected health and dental care costs. The most recent actuarial valuation of the obligation was performed for December 31, 2004. Details related to the post-employment benefits are detailed in Note 10.

(j) Revenue recognition

Service revenue is recorded on the basis of regular meter readings and estimated customer usage since the last meter reading date to the end of the period. The related cost of power is recorded on the basis of the power billed by the Independent Electricity System Operator.

(k) Reclassification

Certain reclassifications have been made to the 2005 financial statements to conform with the classifications used in 2006.

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

3. **SHORT-TERM INVESTMENT**

	2006 \$	2005 \$
Corporate bonds	-	412,700
International bond and investment fund	805,305	-
	805,305	412,700

The investment includes bankers acceptances and debt instruments. The market value of the investments at December 31, 2006 is \$ 807,365 (2005 - \$ 416,152).

4. **INCOME TAXES RECEIVABLE**

As described in Note 2, the Company is required to make payments-in-lieu of income taxes. Future income taxes are not recorded in the accounts since the Company follows the taxes payable method. The future tax asset balance is \$ 4,030,000 (2005 - \$ 3,806,194). This asset is determined by calculating the difference between the tax basis of the asset and its carrying amount on the balance sheet. Future tax assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to be recovered or settled.

5. **REGULATORY ASSETS**

The Company has accumulated certain variance accounts representing purchase of power costs in excess of revenue billed to customers. The OEB regulates both the amounts that can be charged to the Company and the rates that the Company bills to its customers. In 2002, an amount of \$ 2,713,020 representing specific variance accounts was written off since management assessed the likelihood of future recovery to be low. In 2003, the Ontario government introduced Bill 4 which permitted Local Distribution Companies (LDC's) to recover regulatory assets and variance accounts over a four year period starting April 1, 2004. The amounts written off in 2002 are being recorded as received. The amount received and recorded in 2006 related to these accounts totalled \$ 716,114 (2005 - \$ 924,419).

	2006 \$	2005 \$
Deferred qualifying transition costs	181,358	203,671
Retail settlement variances	1,250,297	1,639,910
	1,431,655	1,843,581

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

6. PROPERTY, PLANT AND EQUIPMENT

	Cost \$	Accumulated Amortization \$	2006 Net book value \$	2005 Net book value \$
Land	2,460,799	-	2,460,799	1,458,530
Transmission and distribution systems	73,165,464	37,780,761	35,384,703	35,294,804
Office equipment	1,767,387	1,038,982	728,405	481,805
Plant and equipment	4,183,084	2,912,163	1,270,921	1,342,819
Leasehold improvements	390,126	280,386	109,740	114,136
	81,966,860	42,012,292	39,954,568	38,692,094

Amortization for the year totalled \$ 3,571,475 (2005 - \$ 3,001,408).

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2006 \$	2005 \$
Accounts payable - purchased power	4,164,711	5,296,902
Other accounts payable and accrued liabilities	1,324,773	1,366,084
Water and sewer billings payable	1,106,304	1,040,376
Credits on customer accounts	770,982	849,862
Fixed energy rate rebate payable	66,611	1,008,761
	7,433,381	9,561,985

8. DUE FROM (TO) RELATED PARTIES AND RELATED PARTY TRANSACTIONS

- (a) During the year the Company entered into transactions with its parent, Newmarket Hydro Holdings Inc. (NHHI) and with The Town of Newmarket which is the sole shareholder of Newmarket Hydro Holdings Inc. Revenue charged during the year included energy, street light capital and street light maintenance charged at commercial rates to the Town of Newmarket.

In addition, included in amounts payable are water and sewer amounts collected which are due to the Town. These amounts are collected and remitted in accordance with a contract with URB Olameter and remitted on their behalf.

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

8. **DUE FROM (TO) RELATED PARTIES AND RELATED PARTY TRANSACTIONS, continued**

(b) Details of transactions with the Town of Newmarket during the year are as follows:

	2006 \$	2005 \$
Revenue		
Energy sales	1,588,003	1,622,892
Services - Street light capital	175,632	57,082
Services - Street light maintenance	224,396	224,396
	<u>1,988,031</u>	<u>1,904,370</u>
Expenses		
Interest	1,685,000	1,662,000
Donations	-	1,885,000
Rent, property tax and other	282,532	339,054
	<u>1,967,532</u>	<u>3,886,054</u>
Other		
Purchase of land	-	115,000

(c) The following amounts due to/from the Town of Newmarket are included in the financial statements:

	2006 \$	2005 \$
Accounts receivable	163,282	154,689
Accounts payable	(40,050)	(44,000)
	<u>123,232</u>	<u>110,689</u>

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

9. **NOTE PAYABLE**

	2006 \$	2005 \$
Note payable	22,000,000	22,000,000

The note payable is an unsecured promissory note to the Town of Newmarket. The note bears interest at a deemed rate as permitted by the Ontario Energy Board. The rate for 2006 was 7.25% (2005 - 7.25%). Changes to the terms of the note require 13 months notice. The note has been subordinated to the IESO letter of credit referred to in Note 13.

10. **EMPLOYEE FUTURE BENEFITS**

The Company provides certain health, dental and life insurance benefits for retired employees pursuant to the Company's policy. The accrued benefit obligation and net periodic expense for the year were determined by actuarial valuation. The most recent valuation was performed December 31, 2004. The transitional obligation resulting from the implementation of the policy is being amortized over the average remaining service life period of employees being 8 years.

Significant actuarial assumptions employed for the valuations are as follows: future general inflation level of 2.1%, discount rate of 5.75%, salary and wage level increases at 3% per annum. For measurement purposes, an 8% annual increase in the per capita cost of health benefits was assumed for 2006. The rate was assumed to decrease annually by 1% to a rate of 5% for 2009 and thereafter. A 5% annual rate of increase in the per capita cost of covered dental costs was assumed for 2006 and thereafter. Information about the Company's defined benefit plan is included in the table which follows.

	2006 \$	2005 \$
Accrued Benefit Obligation, beginning of year	613,643	514,043
Current service cost	68,573	76,873
Amortization of the transitional obligation	37,727	37,727
Benefits paid	(15,000)	(15,000)
Accrued Benefit Obligation, end of year	704,943	613,643
Unamortized Transitional Obligation	150,908	188,635
Accrued Benefits Liability	855,851	802,278

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

11. SHARE CAPITAL

Authorized
 Unlimited number of common shares

Issued

	2006	2005
	\$	\$
1,001 common shares	25,806,563	25,806,563

12. STATEMENT OF CASH FLOWS

	2006	2005
	\$	\$
Decrease (increase) in accounts receivable	(2,769,112)	808,710
Decrease (increase) in income taxes receivable	224,077	(224,077)
Decrease (increase) in inventory	(367,015)	89,060
Decrease (increase) in short-term investment	(392,605)	2,475,750
Increase in prepaid and other	(32,015)	(46,883)
Increase in unbilled revenue	(295,790)	(296,723)
Increase (decrease) in accounts payable and accrued liabilities	(2,128,604)	2,669,201
Increase (decrease) in income taxes payable	238,078	(299,448)
Increase (decrease) in deferred revenue	56,559	(4,393)
	(5,466,427)	5,171,197

OTHER INFORMATION

Interest paid	1,778,121	1,709,512
Interest received	496,202	304,596
Income taxes paid	1,759,396	1,082,400

NEWMARKET HYDRO LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

13. SHORT TERM CREDIT FACILITIES

The Company has a \$ 1,500,000 operating loan available from a major chartered bank. The facility is a 364 day revolving operating loan, bearing interest at prime, to be repaid with one year from date of acquisition unless extended by the bank. A standby fee of 10 basis points, payable quarterly in arrears applies to any unused portion of the facility. As at the balance sheet date, the Company has no balance outstanding on this facility. The operating loan includes restrictive clauses with respect to repayment.

The Company has provided prudential support in the amount of \$ 5,406,833 to the Independent Market Operator. The prudential support is secured by a letter of credit with a major chartered bank for \$ 8,505,000 and contains restrictive clauses with respect to debt repayments.

14. PENSION AGREEMENT

The Company makes contributions to the Ontario Municipal Employees' Retirement Fund (O.M.E.R.S.), which is a multi-employer plan, on behalf of its employees. The plan is a defined benefit plan which specifies the amount of retirement benefits to be received by the employees based on the length of service and rates of pay.

The amount contributed to O.M.E.R.S. for 2006 was \$ 220,573 (2005 - \$ 196,080) for current service.

15. COMMITMENTS

Pursuant to the Ontario Energy Board's EB-2005-0315, Newmarket Hydro Ltd. has been instructed to participate in the construction of the Holland Junction transformer station in order to provide additional electricity supply to the northern York region. The total cost of the Holland Junction transformer station is estimated to be \$ 13.85 million., The Company's share of the cost is estimated to be \$ 4 million. Costs of \$ nil related to the project were incurred in 2006.

The Government of the Province of Ontario through Bill 21 has indicated that 800,000 "Smart Meters" will be installed throughout the province by 2007 and that every meter will be a smart meter by 2010. The exact cost to implement the project in the Town of Newmarket is unknown, however, the Company anticipates that the cost could result in a capital outlay of over \$ 3 million. During the year, approximately \$ 280,00 was spent related to the implementation.

NEWMARKET HYDRO LTD.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

16. CONTINGENCIES

(a) In the normal course of business, the Corporation enters into agreements that meet the definition of a guarantee. The guarantees include indemnities under lease agreements, purchase and sale agreements, confidentiality agreements, outsourcing, service and information agreements. The nature of these indemnification agreements prevents the Company from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability related to the likelihood and predictability of future events. Historically, the Company has not made any significant payments under similar indemnification agreements and therefore no amount has been accrued in the balance sheet with respect to these agreements.

(b) Indemnity has been provided to all directors and/or officers of the Company for various items including, but not limited to, all costs to settle suits or actions due to association with the Company, subject to certain restrictions. The Company has purchased directors' and officers' liability insurance to mitigate the cost of any potential suits or actions. The amount of any potential future liability which exceed the amount of insurance coverage cannot be reasonably be determined.

(c) The Company participates with other municipal utilities in Ontario in an agreement to exchange reciprocal contracts of indemnity through the Municipal Electric Association Reciprocal Insurance Exchange. Under this agreement, the Company is contingently liable for additional assessments to the extent that premiums collected are not sufficient to cover actual losses, claims and costs experienced.

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

The claim is that late payment penalties result in municipal electrical 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 Distributors Association is undertaking the defence of this class action. At this time it is not possible to quantify the effect, if any, on these financial statements, and as such no accrual of any potential liability has been recognized.

NEWMARKET HYDRO LTD.
NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2006

17. SUBSEQUENT EVENT

On March 8, 2007, the company received approval from the OEB in respect to a merger with Tay Hydro Electric Distribution Company Inc. This merger will be effective on the close of business April 30, 2007. Tay Hydro Electric Distribution Company Inc. is a licensed local distribution company that distributes electricity to approximately 4,000 customers in the Township of Tay.

Newmarket Hydro Ltd. will hold approximately 93% of all outstanding common shares of the combined entity.