ST. THOMAS ENERGY INC.

Financial Statements

December 31, 2005

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For the Year Ended December 31, 2005

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AUDITORS' REPORT

To the shareholder of
St. Thomas Energy Inc.

We have audited the balance sheet of **St. Thomas Energy Inc.** as at December 31, 2005 and the statements of retained earnings, operations and cash flow 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 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, 2005 and the results of its operations for the year then ended in accordance with Canadian generally accepted accounting principles.

St. Thomas, Ontario
February 16, 2006

Graham Scott Enns
CHARTERED ACCOUNTANTS

ST. THOMAS ENERGY INC.

Balance Sheet
As At December 31, 2005

	2005 $	2004 $
ASSETS		
CURRENT ASSETS		
Cash	**3,985,494**	1,231,499
Income taxes recoverable	**386,168**	710,454
Accounts receivable (net of allowance -$385,000: 2004 -$272,000)	**1,850,446**	2,165,855
Unbilled revenue	**3,699,601**	3,371,410
Prepaid expenses	**5,712**	12,619
	9,927,421	7,491,837
CAPITAL ASSETS (NOTE 4)	**18,319,518**	17,626,939
OTHER ASSETS		
Regulatory accounts (Note 3)	**146,991**	-
Due from St. Thomas Holding Inc. (Note 10)	**11,579**	11,508
	158,570	11,508
TOTAL ASSETS	**28,405,509**	25,130,284
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**5,126,661**	3,815,437
Regulatory accounts (Note 3)	**-**	214,716
Current portion of due to St. Thomas Energy Services Inc. (Note 10)	**1,166,402**	1,038,617
Current portion of customer deposits (Note 5)	**109,165**	133,700
	6,402,228	5,202,470
LONG-TERM LIABILITIES (NOTE 7)	**7,714,426**	7,714,426
CUSTOMER DEPOSITS (NOTE 5)	**599,337**	534,863
DUE TO ST. THOMAS ENERGY SERVICES INC. (NOTE 10)	**2,731,634**	1,898,523
TOTAL LIABILITIES	**17,447,625**	15,350,282
SHAREHOLDER'S EQUITY		
CAPITAL STOCK (NOTE 8)	**7,714,426**	7,714,426
RETAINED EARNINGS	**3,243,458**	2,065,576
	10,957,884	9,780,002
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	**28,405,509**	25,130,284

See accompanying notes to the financial statements.

ST. THOMAS ENERGY INC.

Statement of Retained Earnings
For the Year Ended December 31, 2005

	2005	2004
	$	$
BALANCE, BEGINNING OF YEAR	**2,065,576**	1,168,448
Net income for the year	**1,177,882**	897,128
BALANCE, END OF YEAR	**3,243,458**	2,065,576

See accompanying notes to the financial statements.

ST. THOMAS ENERGY INC.

Statement of Operations
For the Year Ended December 31, 2005

	2005 $	2004 $
REVENUES		
Gross revenue	**34,304,407**	29,638,120
Flow-through costs	**(28,709,531)**	(24,097,152)
Net revenue from electrical distribution	**5,594,876**	5,540,968
Recovery of regulatory assets (Note 3)	**593,756**	-
Other service revenue	**444,952**	410,861
Late payment charges	**137,273**	63,445
Interest	**122,818**	148,584
	6,893,675	6,163,858
EXPENDITURES		
Operating and maintenance of :		
Distribution system	**654,864**	653,121
Office building	**181,783**	147,419
Meters	**95,188**	87,547
Substations	**26,259**	70,842
Transformers	**55,541**	81,237
Amortization	**1,136,353**	1,074,900
Business promotion	**1,347**	956
Customer premises	**49,648**	36,902
Interest - long-term debt	**559,296**	560,926
- customer deposits	**13,481**	28,313
Meter reading, billing and collection	**1,075,428**	978,595
Office administration	**491,185**	364,166
Salaries - Administration	**409,086**	284,359
- Directors	**16,386**	14,954
Professional services and consulting	**73,354**	39,809
	4,839,199	4,424,046
LOSS ON DISPOSAL OF CAPITAL ASSETS	**-**	49,179
INCOME BEFORE PAYMENT IN LIEU OF TAXES	**2,054,476**	1,690,633
PROVISION FOR PAYMENT IN LIEU OF TAXES (NOTE 11)	**876,594**	793,505
NET INCOME FOR THE YEAR	**1,177,882**	897,128

See accompanying notes to the financial statements.

ST. THOMAS ENERGY INC.

Statement of Cash Flow
For the Year Ended December 31, 2005

	2005	2004
	$	$
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	**35,467,607**	29,712,334
Cash paid to suppliers and employees	**(29,903,053)**	(25,225,155)
Interest received	**122,818**	148,584
Interest paid	**(1,191,193)**	(1,229,239)
Payment in lieu of income taxes paid	**(552,308)**	(1,506,856)
Cash flows provided by operating activities	**3,943,871**	1,899,668
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to capital assets	**(1,828,933)**	(1,354,887)
Proceeds on disposal of capital assets	**-**	99,197
Decrease (increase) in regulatory assets	**(361,707)**	548,629
Cash flows (used in) investing activities	**(2,190,640)**	(707,061)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Decrease) increase in due to St. Thomas Energy Services	**960,895**	(1,073,332)
Decrease (increase) in due from St. Thomas Holding	**(71)**	-
(Decrease) in long-term debt	**-**	(96,716)
Increase (decrease) in customer deposits	**39,940**	(602,258)
Cash flows provided by (used in) financing activities	**1,000,764**	(1,772,306)
NET INCREASE (DECREASE) IN CASH	**2,753,995**	(579,699)
CASH, BEGINNING OF YEAR	**1,231,499**	1,811,198
CASH, END OF YEAR	**3,985,494**	1,231,499

See accompanying notes to the financial statements.

1. NATURE OF BUSINESS

St. Thomas Energy Inc. (the Company) is 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 Inc. is the transmission and distribution of electricity to customers within the St. Thomas area and the business is primarily regulated by the Ontario Energy Board (OEB).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These policies require management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reported 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 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:

<u>Rate-setting</u>

The Ontario Energy Board Act 1998 gave the OEB increased powers and responsibilities to regulate the electricity industry. These powers and responsibilities include the power to approve or fix rates for the transmission and distribution of electricity and that distribution companies fulfill obligations to connect and service customers. The transitional rate orders issued by the OEB approved the transmission and distribution revenue requirements for 2001, which were designed to permit these regulated businesses to recover their allowed costs and to earn a forecasted annual rate of return of 9.88%.

The OEB has the general power to include or exclude costs, revenues, losses or gains in the rates of a specific period, resulting in a change in the timing of accounting recognition from that which would have applied in an unregulated company. Such change in timing involves the application of rate regulated accounting, giving rise to the recognition of regulatory assets and liabilities. The Company's regulatory assets represent certain amounts receivable from future customers and costs that have been deferred for accounting purposes because it is probable that they will be recovered in future rates. Specific regulatory assets are disclosed in Note 3.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

On December 9, 2004, the OEB issued its decision on the prudence of various regulatory deferral accounts incurred prior to December 31, 2003, plus interest. As a result of the OEB's decision, the proportion of our regulatory assets subject to potential future disallowance has been significantly reduced. The Company continually assesses the likelihood of recovery of each of its regulatory assets and continues to believe that it is probable that the OEB will factor its regulatory assets into the setting of future rates. If, at some future date, the Company judges that it is no longer probable that the OEB will include a regulatory asset in future rates, the appropriate carrying amounts will be reflected in results of operations in the period that the assessment is made.

Property, Plant and Equipment

Property, plant and equipment are stated at cost and are amortized on the straight-line basis over their estimated service lives. No amortization is provided for construction in progress. The amortization rates are as follows:

	Life Years	Rate
Buildings	50	2.00%
Distribution system	25	4.00%
Transformers	25	4.00%
Meters	25	4.00%
Substations	30	3.33%
Computers	5	20.00%

When non-grouped capital assets are 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 capital assets 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.

Revenue Recognition

Hydro power revenue is recorded on the basis of regular meter readings and unbilled revenue is based on estimates of customer usage from the last meter reading to the end of the year. The purchase of hydro power is recorded in the month to which it relates.

Contributions in aid of construction

All contributions to capital costs received are included in capital assets as an offset to distribution system assets and amortized over their estimated useful lives.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Corporate Income and Capital Taxes

Under the Electricity Act, 1998, St. Thomas Energy 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 Company provides for payments in lieu of corporate income taxes relating to its regulated business using the taxes payable method as directed by the OEB. 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 for accounting purposes. When unrecorded future income taxes become payable, it is expected that they will be included in the rates approved by the OEB and recovered from customers of St. Thomas Energy at that time.

3. REGULATORY ACCOUNTS

	2005	2004
	$	$
Market ready	**836,775**	1,258,154
Pre-market open power variance account	**898,034**	843,756
Retail settlement variance accounts	**37,507**	(90,197)
Amounts recovered to December 31	**(1,215,914)**	(730,357)
	556,402	1,281,356
Less: allowance for uncertain recovery	**409,411**	1,496,072
	146,991	(214,716)

The *Electricity Pricing, Conservation and Supply Act, 2002* (Bill 210), which amended the Electricity Act, 1998 and other statutes for the purpose of implementing the Electricity Action Plan announced by Premier of Ontario on November 11, 2002. Subject to future OEB approval, the *Electricity Pricing, Conservation and Supply Act, 2002* allowed for establishment of a regulatory deferral account to record receivables and costs for amounts to be recovered from future customers. Due to the uncertainty of recovery, amounts recorded in this regulatory deferral account between May 1, 2002 and December 31, 2003 were allowed for and expensed against operations of those periods.

3. REGULATORY ACCOUNTS (CONTINUED)

The Ontario Energy Board allowed in the submission of the 2004 rate applications (for increases to take effect April 1, 2004) for collection on 25% (Phase One) of Market Ready (Transitional), Pre-Market Open Power Variance and Retail Settlement Variance costs as reported above for the 2002 year. It is further indicated that these costs are to be recovered over a four year period beginning in 2004 and that the final determination of allowable costs will rest with the Ontario Energy Board during that time period. As a result of this submission, the Company set up regulatory assets for the fiscal 2004 period and applied approximately $628,000 of recoveries for the period April 1, 2004 to December 31, 2004 to these regulatory asset accounts.

The Ontario Energy Board allowed in the submission of the 2005 rate applications (for increases to take effect April 1, 2005) for collection of 33% of Market Ready (Transitional), Pre-Market Open Power Variance and Retail Settlement Variance (RSV) costs as reported above for the 2003 year. In addition, the OEB approved the final increase in rates to the 9.88% Rate of Return on equity with restrictions that it's first year use must be directly related to Demand Side Management application and as such $183,075 has been allocated to the RSV account for amounts collected to date.

As a result of the approved 2005 rate application the Company has recovered as at December 31, 2005 $593,756 of regulatory assets previously allowed for in the period May 1, 2002 to December 31, 2003. This amount has been included in income for the current period. The Company continues to believe that it is probable that the remain regulatory assets will be recovered through future rates, although there is still some uncertainty about full recovery. If these costs are recovered in 2006 and subsequent years the Company would recognize a gain in the results of operations in the period the funds are collected.

In the absence of rate regulated accounting distribution revenue would have been $137,000 higher and interest income would be $62,500 lower.

4. CAPITAL ASSETS

	Cost $	Accumulated Amortization $	**2005** **$**	2004 $
Land	180,398	-	**180,398**	180,398
Buildings	2,385,250	602,410	**1,782,840**	1,832,473
Distribution system	14,278,254	5,408,408	**8,869,846**	8,334,102
Transformers	6,916,739	3,085,286	**3,831,453**	3,650,671
Meters	2,110,048	1,071,172	**1,038,876**	1,056,044
Substations	6,667,483	4,080,712	**2,586,771**	2,296,787
Computers	43,592	14,258	**29,334**	32,241
Work in progress	-	-	**-**	244,223
	32,581,764	14,262,246	**18,319,518**	17,626,939

5. CUSTOMER DEPOSITS

	2005	2004
	$	$
Customer deposits	**708,502**	668,563
Less: Current portion	**109,165**	133,700
	599,337	534,863

6. ELECTRICITY CREDITS TO CUSTOMERS

Under a new regulation issued in October 2005, Regulated Price Plan customers received a one-time credit reflecting a lower cost of power than the fixed commodity price between April 1, 2004 and March 31, 2005. In the fourth quarter of 2005, purchased power costs was reduced by $1,631,000 and included in accrued liabilities until customers accounts were credited in January of 2006. The application of the one-time credit will not result in any adjustment to net income in the current or future reporting periods

7. LONG-TERM LIABILITIES

	2005	2004
	$	$
Note payable- City of St Thomas, interest only, payable semi-annual, 7.25%, due December 2010 (unsecured)	**7,714,426**	7,714,426

In 2005 St. Thomas Energy Inc. paid the City of St. Thomas $618,416 of accrued interest from prior years and $559,296 of current year interest.

8. CAPITAL STOCK

	2005	2004
	$	$
Authorized Capital:		
Unlimited common shares		
Stated Capital:		
1000 Common shares	**7,714,426**	7,714,426

9. CONTINGENT LIABILITY

A class action lawsuit 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 the representative of the Defendant Class consisting of all municipal utilities in Ontario which 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 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 Electric Distributors Association is undertaking the defense of this class action. At this time it is not possible to quantify the effect, if any, on the financial statements.

10. RELATED PARTY TRANSACTIONS

During the year, the Company had business transactions with St. Thomas Energy Services Inc. The Company contracts St. Thomas Energy Services Inc. to build and maintain its capital infrastructure as well as bill and collect its 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. In addition, St. Thomas Energy Inc. paid it's sole shareholder (City of St. Thomas) interest on the outstanding note payable.
The particulars of these transactions and balances owing from or to these corporations for the years ended December 31, were as follows:

	2005	2004
Transactions during the year:	**$**	$
St. Thomas Energy Services Inc.		
Purchase of capitalized items	**2,143,589**	2,394,247
Purchase of services	**2,961,184**	2,566,146
Building rental payments received	**250,000**	250,000
City of St. Thomas		
Interest on long-term debt	**559,296**	559,296
Balances at end of year:		
Amounts due from St. Thomas Holding Inc.	**11,579**	11,508
Amounts due to St. Thomas Energy Services Inc. (current)	**1,166,402**	1,038,617
Amounts due to St. Thomas Energy Services Inc, (long-term)	**2,731,634**	1,898,523
Accrued interest payable to City of St. Thomas	**-**	618,416

11. PROVISION FOR PAYMENT IN LIEU OF TAXES

	2005	2004
	$	$
Income before provision for PIL's	**2,054,476**	1,690,633
Combined rate of federal and provincial income tax	**36.12%**	36.12%
Provision for PILs at statutory rate	**742,077**	610,657
Increases resulting fom:		
Capital taxes included in PIL provision (net of tax)	**32,343**	30,662
Capital cost allowance less than amortization	**102,174**	152,186
	876,594	793,505

Future income taxes relating to regulated businesses have not been recorded in the accounts as they are expected to be recovered through future revenues. As at December 31, 2005, future income tax assets of $1,189,000 ($998,000 -2004), based on substantively enacted income tax rates, have not been recorded. In the absence of rate regulated accounting, the Company's provision for PIL would have been recognized on an accrual basis rather than under the taxes payable method. As result, the provision for PILs would have been lower by approximately $102,000.

12. COMMITMENTS

Purchasers of electricity in Ontario, through the IMO, are required to provide security to mitigate the risk of their default based on their expected activity in the market. The IMO could draw on these guarantees if St. Thomas Energy Inc. fails to make a payment required by a default notice issued by the IMO. As at December 31, 2005, the Company provided prudential support of $1,958,376.

13. FINANCIAL INSTRUMENTS

Foreign currency risk

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

Credit risk

The corporation does not have any significant exposure to any individual customer.

Fair value

The carrying value of accounts receivable, prepaids, and accounts payable 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.