



ALGONQUIN POWER

INCOME FUND

Annual Report
December 31, 1997

ALGONQUIN POWER INCOME FUND

Annual Report

September 8 to December 31, 1997

Algonquin Power Income Fund (the "Fund") was established by a Declaration of Trust on September 8, 1997 and completed an initial public offering of Trust Units on December 23, 1997. The Fund's first year end was December 31, 1997 and pursuant to applicable securities regulatory requirements, the Fund is required to provide Unitholders an Annual Report for the period of September 8 to December 31, 1997.

Profile

The Fund is an unincorporated open-ended trust established under the laws of Ontario. The Fund was created to acquire a direct or indirect equity interest in 17 hydroelectric generating facilities located in Ontario (5), Québec (3), New York State (7) and New Hampshire (2).

The Fund intends to make quarterly payments of distributable cash derived from these facilities to the maximum extent possible. Distributable cash includes all interest, lease payments and dividend and other income or return of capital received by the Fund less, among other things, expenses of the Fund.

As at December 31, 1997, the Fund had 8,031,775 Trust Units outstanding. The Trust Units trade on The Toronto Stock Exchange and the Montreal Exchange under the symbol APF.UN.

Algonquin Power Income Fund is governed by three independent trustees. The Fund is managed by Algonquin Management Inc., a wholly owned subsidiary of Algonquin Power Corporation Inc. Trust Units are qualified investments under the Income Tax Act (Canada) for trusts governed by RRSPs, RRIFs and DPSPs and will not be considered foreign property of such plans.

**REPORT TO
UNITHOLDERS**

I am pleased to present your Fund's first Annual Report. The Fund completed an initial public offering of Trust Units on December 23, 1997 and used a portion of the net proceeds to acquire an interest in certain hydroelectric generating facilities at that time. The Fund was only active for part of the 1997 year. During that short period of time, the generating facilities were operating according to plan.

I am also pleased to report that the Fund successfully completed the three acquisitions pending at December 31, 1997. On February 12, 1998, the Fund completed the purchase of the Belleterre Hydroelectric Generating Facility and the Ste-Brigitte Generating Facility. On April 17, 1998, the Fund completed the acquisition of certain interests in the Long Sault Rapids Generating Facility.

I would like to take this opportunity to thank all of the Fund's advisors and my fellow Trustees for their dedication, as well as our Unitholders for their interest in the Algonquin Power Income Fund.

Respectfully submitted on behalf of the
Trustees of the Algonquin Power Income Fund



Stephen Probyn
Chairman

The Consolidated Balance Sheet as at December 31, 1997, the Consolidated Statement of Operations and Deficit and the Consolidated Statement of Changes in Financial Position reflect the results of the Fund's operations from the date of the formation of the Fund pursuant to the Declaration of Trust dated September 8, 1997.

Significant Transactions

The Fund completed its initial public offering of 8,031,775 trust units at a price of \$10.00 per unit on December 23, 1997. The Fund raised \$73.8 million net of issue costs.

The Fund acquired for \$27.5 million the rights to 100% of the cash flows from 14 hydroelectric generating facilities located in Ontario, Québec, New York and New Hampshire. This was accomplished by purchasing \$9.2 million in secured notes issued by companies that operate generating facilities and by purchasing companies and partnership interests that directly own generating facilities. The details of these acquisitions are provided in Note 3 - Acquisitions in the accompanying financial statements. The total generating capacity of these facilities is 19,030 kW.

Net proceeds of \$41.6 million from the offering were placed in escrow to be used in connection with the acquisition of three hydroelectric generating facilities that were to close subsequent to year end. These acquisitions have now been completed. The details of the securities and assets acquired are provided in Note 10 - Subsequent Events in the accompanying financial statements. These acquisitions provide the Fund with 100% of the cash flows from three large facilities, adding an additional generating capacity of 24,400 kW.

The Fund also acquired on December 23, 1997 a note issued by Algonquin Power Corporation Inc. (APC), the parent company of the Fund's Manager, for \$7.8 million.

Operating Results

The accompanying financial statements provide operating results for only nine days, except for \$53,000 of rental income earned prior to December 23, 1997. The forecast net earnings in the prospectus were for a full year of operations from January 1 to December 31, 1998. Therefore, the results for nine days bear no relationship to forecast results. The 1998 annual report will include a comparison of the actual 1998 operations to the forecast.

The reported loss for this short period has arisen for two reasons. Firstly, there were debt arrangement and prepayment fees of \$2.2 million. These fees were incurred in connection with the completion of one of the acquisitions and were included in the forecast provided in the prospectus.

The Fund was also subject to certain administrative expenses, including a year end audit, that the nine days of revenue were not sufficient to cover. These

MANAGEMENT'S DISCUSSION AND ANALYSIS

expenses were recovered in the first quarter of 1998, and netted with the first quarter operations for purposes of determining first quarter distributable cash.

Financial Condition

As at December 31, the Fund has a working capital deficit of \$1,295,000. This is mainly attributable to the following:

- (1) A \$400,000 shortfall in funds required to complete the various acquisitions because of adverse movements in the US dollar exchange rate on closing as compared to the rate of exchange used in the forecast; and
- (2) Offering expenses of approximately \$800,000 in excess of amounts originally estimated.

Subsequent to year end, APC agreed to provide the Fund with necessary working capital by advancing funds which will be funded by a reduction in the principal amount of the note purchased. The principal repayment schedule on the note will not be adjusted until 2004. Therefore, the reduction in the note will not have an impact on the Fund's distributable cash until 2004.

Risk Management

Due to the ownership of generating facilities in the United States, the Fund's results of operations are affected by the exchange rate between the Canadian and US dollar. The Fund has attempted to reduce the impact of exchange rate fluctuations by agreeing to pay certain of its obligations in US dollars. The management fees payable to Algonquin Management Inc. and the operations supervisory fees payable to Algonquin Power Systems Inc. are in US dollars. As well, the principal repayments on the promissory notes are payable in US dollars. Together, this transfers much of the foreign exchange risk to the Algonquin group of companies.

It is not the intent of the Fund to engage in any speculative foreign exchange transactions.

On January 1, 2000, many of the world's date sensitive computer systems may fail due to programming that may lead the computer to read "00" as 1900. The Manager has completed an analysis of the potential of this problem as it relates to the computer systems of the Fund's assets. The Manager believes that there will be minimal impact to the operations of the assets and the Manager is now implementing an action plan to rectify any deficiencies in its computer systems.

Outlook

All of the acquisitions outlined in the prospectus have been completed. For 1998, the Fund will receive 100% of the cash flows from 16 of the generating facilities from January 1, 1998. The 17th and largest facility came on stream on April 1, 1998, ahead of the May 1, 1998 schedule anticipated in the forecast. The manager is actively pursuing acquisition opportunities in accordance with the guidelines outlined in the prospectus dated December 11, 1997.

MANAGEMENT'S REPORT

Algonquin Management Inc., as Manager of the Fund, is responsible for the preparation of the financial statements. The financial statements were prepared in accordance with accounting principles generally accepted in Canada and are based on the Manager's best estimates and judgements.

The Manager is also responsible for maintaining a system of internal controls designed to provide reasonable assurance as to the reliability of the financial records and the safeguarding of assets.

KPMG, the independent auditors appointed by the unitholders, have conducted an examination of the corporate and accounting records and expressed their opinion on the financial statements of the Fund. The Trustees of the Fund, all of whom are members of the Audit Committee, have approved the financial statements of the Fund.

MANAGEMENT'S REPORT

**AUDITORS'
REPORT**

AUDITORS' REPORT TO THE TRUSTEES

We have audited the consolidated balance sheet of Algonquin Power Income Fund as at December 31, 1997 and the consolidated statements of operations and deficit and changes in financial position for the period September 8, 1997 (date of Declaration of the Trust) to December 31, 1997. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with 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 consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 1997 and the results of its operations and the changes in its financial position for the period then ended in accordance with generally accepted accounting principles.



Chartered Accountants

Toronto, Canada
April 28, 1998

Algonquin Power Income Fund
 Consolidated Balance Sheet
 December 31, 1997

**CONSOLIDATED
 BALANCE
 SHEET**

Assets

Current assets

Cash	\$ 417,630
Amounts receivable	535,129
Notes receivable - current portion (Note 4)	152,100
Prepaid expenses	23,444
	<u>1,128,303</u>

Notes receivable (Note 4) 16,852,428

Funds in escrow (Note 5) 41,553,644

Capital assets, at cost (Note 6) 18,376,330

Deferred foreign exchange loss 36,898

\$ 77,947,603

Liabilities

Current liabilities

Accounts payable and accrued liabilities	\$ 1,274,446
Due to Algonquin group of companies	1,148,997
	<u>2,423,443</u>

Notes payable (Note 7) 4,143,514

6,566,957

Unitholders' Equity

Trust units (Note 2) 73,811,146

Deficit (2,430,500)

71,380,646

\$ 77,947,603

Commitments (Note 11)

Approved by the Trustees:



Trustee



Trustee

**CONSOLIDATED
STATEMENT OF
OPERATIONS
AND DEFICIT**

Algonquin Power Income Fund
Consolidated Statement of Operations and Deficit
From Date of Declaration of Trust, September 8, 1997
To December 31, 1997

Revenue	
Energy sales	\$ 43,732
Interest and rental income	90,950
	<u>134,682</u>
Expenses	
Operating	21,765
Amortization of capital assets	28,821
Debt arrangement and prepayment fees (Note 3)	2,258,413
Management fees	6,338
Operations supervisory fees	6,338
Administrative expenses	167,851
Loss on foreign exchange	1,645
	<u>2,491,171</u>
Loss before interest expense	(2,356,489)
Interest expense	74,011
Net loss for the period, being Deficit	<u>\$ (2,430,500)</u>
Net loss per trust unit	<u>\$ (0.30)</u>

Algonquin Power Income Fund
 Consolidated Statement of Changes in Financial Position
 From Date of Declaration of Trust, September 8, 1997
 To December 31, 1997

Operating Activities

Net loss	\$ (2,430,500)
Items not affecting cash	
Amortization of capital assets	28,821
Loss on early repayment of notes payable	1,564,547
	<u>(837,132)</u>
Change in non-cash operating working capital	1,740,540
	<u>903,408</u>

Financing Activities

Issue of trust units	80,317,750
Expenses of trust units offering	(6,506,604)
Issue of notes payable at date of acquisition	10,401,700
Repayment of notes payable	(7,822,733)
	<u>76,390,113</u>

Investing Activities

Increase in funds in escrow	(41,553,644)
Acquisition of notes receivable	(17,041,426)
Acquisition of operating entities	(18,280,821)
	<u>(76,875,891)</u>

Increase in Cash, being Cash, end of period

\$	<u>417,630</u>
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**CONSOLIDATED
 STATEMENT
 OF CHANGES
 IN FINANCIAL
 POSITION**

**NOTES
TO THE
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STATEMENTS****Algonquin Power Income Fund**
Notes To The Consolidated Financial Statements
December 31, 1997

Algonquin Power Income Fund (the "Fund") is an open-ended, unincorporated Trust established pursuant to the Declaration of Trust dated September 8, 1997 under the laws of the Province of Ontario. The Fund's principal business activity is the ownership and management of hydroelectric generating facilities. The Fund is managed by Algonquin Management Inc., a wholly owned subsidiary of Algonquin Power Corporation Inc. ("APC"). Another subsidiary of APC, Algonquin Power Systems Inc., operates the hydroelectric facilities on a day to day basis and a third subsidiary of APC, Construction Services Inc., provides construction services to the Fund. Collectively, these companies are referred to as the Algonquin group of companies.

1. Significant Accounting Policies**(a) Basis of Consolidation**

The consolidated financial statements of the Fund have been prepared in accordance with accounting principles generally accepted in Canada, and include the accounts of its wholly-owned subsidiaries, Algonquin Power Fund (Canada) Inc., and Algonquin Power Fund (America) Inc. These subsidiaries wholly own the following:

- (i) Société Hydro-Donnacona S.E.N.C. Partnership;
- (ii) HDI Associates I Partnership;
- (iii) Marsh Hydropower Inc.;
- (iv) Marsh Hydropower (Trent Valley) Inc.; and
- (v) Algonquin Power Fund (America) Holdco Inc.

All significant intercompany transactions and balances have been eliminated.

(b) Capital Assets

Capital assets, being land, hydroelectric generating facilities and licences, are recorded at cost. Development costs, including the cost of acquiring or constructing facilities together with the related interest costs during the period of construction are capitalized. Improvements that increase or prolong the service life or capacity of an asset are capitalized. Maintenance and repair costs are expensed as incurred.

The hydroelectric generating facilities are amortized on a straight line basis over the estimated useful life of the facility. These periods range from 25 to 40 years.

The costs attributable to establishing exemptions from Federal Energy Regulatory Commission licencing requirements in the United States are being amortized on a straight line basis over the term of the licence.

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STATEMENTS***Significant Accounting Policies - continued***(c) Notes Receivable**

Notes receivable intended to be held to maturity are carried at the lower of cost or estimated realizable value. Estimated realizable value is the expected future cash flows discounted at the rate of interest inherent in the investment on acquisition, which at the date of the financial statements equals cost. Interest is being recognized on an effective yield basis.

(d) Recognition of Revenue

Revenue is derived from energy sales and is recorded at the time electrical energy is delivered.

Interest income from notes held is recorded as earned. In the case of contingent participation agreements, income is recorded when cash is received.

(e) Foreign Currency Translation

The Fund's United States subsidiaries and partnership interests are considered to be functionally integrated with the Canadian operations. All monetary assets and liabilities denominated in United States dollars are translated into Canadian dollars at year end exchange rates, whereas non-monetary assets and liabilities are translated at the rate in effect at the transaction date. The revenues and expenses of these integrated operations are translated at the average rate of exchange in effect during the period. The foreign currency translation adjustment is reflected in the consolidated statement of operations, except for exchange gains or losses relating to long-term foreign currency monetary assets or liabilities, which are deferred and amortized over the term of the related item.

(f) Income Taxes

As the Fund is an unincorporated trust, it is entitled to deduct distributions to unitholders to the extent of its taxable income and consequently, it is expected that the Fund will not be liable for any material tax under the Tax Act, as this will be the responsibility of the individual unitholder.

Any provision for income taxes will relate solely to the income taxes of the Fund's wholly owned subsidiaries. Deferred taxes will be recognized where differences arise between income recorded for accounting purposes and for tax purposes.

(g) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the period. Actual results could differ from estimates. During the fiscal period presented, management has made a number of estimates and valuation assumptions, including estimates of net realizable value of amounts and notes receivable, the useful lives of capital assets, and

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Significant Accounting Policies - continued

the fair value of financial assets and liabilities. These estimates and valuation assumptions are based on present conditions and management's planned course of action, as well as assumptions about future business and economic conditions. Should the underlying valuation assumptions and estimates change, the recorded amounts could change by a material amount.

2. Trust Units

Authorized Trust Units

The Declaration of Trust provides that an unlimited number of units may be issued. Each unit represents an undivided beneficial interest in any distribution from the Fund and in the net assets in the event of termination or wind-up. All units are the same class with equal rights and privileges.

Trust units are redeemable at the holder's option at amounts related to market prices at the time subject to a maximum of \$10,000 in cash redemptions in any particular calendar month. Redemptions in excess of this amount shall be paid by way of a distribution in specie of a pro rata amount of certain of the Fund's assets, including the securities purchased by the Fund, but not to include the generating facilities.

Issued Trust Units

	Number of Units	Amount \$
December 23, 1997 issue	8,031,775	\$80,317,750
Costs of the issue		6,506,604
Total	<u>8,031,775</u>	<u>\$73,811,146</u>

3. Acquisitions

On November 30, 1997, the Fund acquired the following assets:

Generating Facilities

The Fund acquired from APC the hydroelectric generating facility of the Donnacona project in Québec for a purchase consideration of \$10,401,700. The acquisition was financed through the issue of two notes to APC, a loan secured by the equipment in the amount of \$7,822,733 and a promissory note in the amount of \$2,578,967. There is a credit arrangement fee payable to APC in the amount of \$693,866 for the arrangement of the equipment loan. The fee is payable on December 31, 1998.

On December 23, 1997, the Fund utilized certain of the proceeds of the trust unit offering to repay the equipment loan of \$7,822,733 in full. The repayment was subject to a prepayment penalty of \$1,564,547. The Fund has issued a promissory note to APC in satisfaction of this fee.

Acquisitions - continued

On December 23, 1997, the Fund acquired the following assets:

Notes Receivable

(i) Notes issued jointly and severally by Trafalgar Power Inc., a Delaware corporation, and Christine Falls Corporation, a New York corporation (collectively the "Trafalgar Notes") at a cost of \$9,187,280 of which \$690,672 represents a note acquired from APC. Details of the Trafalgar Notes are in Note 4 - Notes Receivable.

(ii) Note issued by APC (the "Algonquin Note") at a cost of \$7,854,146. Details of the Algonquin Note are in Note 4 - Notes Receivable.

Other entities acquired on December 23, 1997 were:

(i) 100% of Société Hydro-Donnacona S.E.N.C. Partnership

The acquisition of 100% of the partnership interests from APC has been accounted for using the purchase method. The consideration paid by the Fund has been allocated to the net assets acquired as follows:

Working capital deficiency	\$ (36,667)
Generating facility	<u>1,536,667</u>
Cash consideration paid	<u>\$ 1,500,000</u>

(ii) 100% of HDI Associates I Partnership

The acquisition of 100% of the partnership interests has been accounted for using the purchase method. The consideration paid by the Fund has been allocated to the net assets acquired as follows:

Working capital	\$ 14,496
Generating facilities	3,144,870
Licences	<u>121,914</u>
Cash consideration paid	<u>\$ 3,281,280</u>

(iii) 100% of the outstanding shares of Marsh Hydropower Inc.

The acquisition of Marsh Hydropower Inc. has been accounted for using the purchase method. The consideration paid by the Fund has been allocated to the net assets acquired as follows:

Working capital	\$ 28,531
Generating facility	<u>650,000</u>
Cash consideration paid	<u>\$ 678,531</u>

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Acquisitions - continued

(iv) 100% of the outstanding shares of Marsh Hydropower (Trent Valley) Inc. The acquisition of Marsh Hydropower (Trent Valley) Inc. has been accounted for using the purchase method. The consideration paid by the Fund was utilized to retire all related and third party debt, and has been allocated to the net assets acquired as follows:

Working capital deficiency	\$ (130,690)
Land	151,250
Generating facilities	<u>2,398,750</u>
Cash consideration paid	<u>\$ 2,419,310</u>

4. Notes Receivable

As detailed in Note 3 - Acquisitions, the Fund acquired the following notes on December 23, 1997. Principal balances due in Canadian dollars at estimated realizable values are:

Trafalgar Class A Note - 9.75% secured note due February 10, 2003, principal amount of US \$5,913,814.	\$ 8,459,710
Trafalgar Class B Note - 6.10% secured note due December 31, 2010, principal amount of US\$15,800,000.	690,672
Algonquin Note - 9.25% secured note due January 1, 2005, note to be repaid in scheduled principal repayments over its term.	<u>7,854,146</u>
	17,004,528
Less - Current portion of principal payments due on the Algonquin Note.	<u>152,100</u>
	<u>\$ 16,852,428</u>

The Trafalgar Notes are secured by a first charge against all assets of the issuing companies including the generating facilities and key operating contracts. The Class B note is subordinate to the Class A note. Payment of principal and interest is structured based on receipt of 100% of the cash flows generated by the seven hydroelectric facilities owned by the companies, with payments first applied to the Class A note. Each year once annual cash flow targets have been determined and applied to reduce the interest and principal outstanding on the Class A note, the remaining cash flow is paid to the Fund as a bonus under the contingency participation agreement. Once the Class A note is paid, a similar arrangement applies to the Class B note. The overall terms of the notes provide for the Fund to receive 100% of cash flows up to 2010 and a right to 75% of the equity value of the facilities upon repayment of the notes.

**NOTES
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Notes Receivable - continued

The Algonquin note is secured by a letter of credit in the amount of \$3,500,000 and an assignment of all amounts owing by the Fund in respect of the \$2,578,967 promissory note payable to APC, and the guarantee of Algonquin Power Systems Inc.

5. Funds In Escrow

On December 23, 1997, certain of the net proceeds of the trust unit offering were set aside with escrow agents pending completion of acquisitions subsequent to year end. These transactions, having been finalized, are detailed in Note 10 - Subsequent Events.

6. Capital Assets

	Cost	Accumulated Amortization	Net Book Value
Land	\$ 151,250	\$ -	\$ 151,250
Generating facilities	18,169,091	28,753	18,140,338
Licences	84,810	68	84,742
	<u>\$ 18,405,151</u>	<u>\$ 28,821</u>	<u>\$ 18,376,330</u>

7. Notes Payable

As detailed in Note 3 - Acquisitions, two promissory notes were issued by the Fund to satisfy obligations arising from the purchase of generating facilities and the prepayment fee for an equipment loan. These notes, which have a fixed principal balance in Canadian dollars, are both payable to APC in United States dollars.

10% per annum, to mature December 31, 2000, with scheduled quarterly principal payments in 1999 and 2000.	\$ 2,578,967
Non-interest bearing, to mature December 31, 2000, with scheduled quarterly principal payments in 1999 and 2000.	<u>1,564,547</u>
	<u>\$ 4,143,514</u>

Principal payments due in the next three years are:

1998	\$ -
1999	1,765,872
2000	<u>2,377,642</u>
	<u>\$ 4,143,514</u>

8. Financial Instruments

The carrying amount of the Fund's cash, amounts receivable, funds in escrow, accounts payable and accrued liabilities, and due to the Algonquin group of

**NOTES
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Financial Instruments - continued

companies approximate fair value due to the short term nature of these financial instruments.

The carrying amount of the Fund's notes receivable approximate fair value due to the fact that the notes were only recently acquired. Under the terms of the Trafalgar Indenture, the Fund also has the right to participate in cash flows in excess of the funding requirements to meet interest and principal payments on the Class A and Class B notes. This right has been given no carrying amount and since the timing of the cash flows is uncertain, it is not practicable to determine the fair market value of that right.

The carrying amount of the Fund's two notes payable that were recently issued approximate their fair value.

9. Income Taxes

The Fund's subsidiaries have accumulated tax losses available to offset taxable income in future years in the amount of approximately \$147,000. These tax losses expire in the year 2004.

10. Subsequent Events

The following acquisitions have been completed subsequent to year end.

- (a) On February 12, 1998, \$20,773,728 plus accumulated interest were released from the funds held in escrow to acquire the following entities:
- (i) 100% of the outstanding shares of BCL Energy (Belleterre) Inc.

The acquisition of BCL Energy (Belleterre) Inc. will be accounted for using the purchase method. The consideration paid by the Fund will be allocated to the net assets acquired as follows:

Generating facility	\$ 11,814,000
Hydro contract acquisition costs	856,660
Payable to Hydro Québec	<u>(414,160)</u>
Cash consideration paid	<u>\$ 12,256,500</u>

A power purchase agreement in place with Hydro Québec stipulates a fee payable to Hydro Québec if energy production does not meet minimum targets. Due to poor operating results produced by previous owners, the Fund assumes the liability for payments of \$103,540 for each of the years from 1998 to 2001. Revised targets are now in place.

Subsequent Events- continued

(ii) 100% of the outstanding shares of BCL Energy (Ste-Brigitte) Inc.

The acquisition of BCL Energy (Ste-Brigitte) Inc. will be accounted for using the purchase method. The consideration paid by the Fund will be allocated to the net assets acquired as follows:

Generating facility	\$ 8,209,778
Hydro contract acquisition costs	652,450
Payable to Hydro Québec	<u>(345,000)</u>
Cash consideration paid	<u>\$ 8,517,228</u>

A power purchase agreement in place with Hydro Québec stipulates a fee payable to Hydro Québec if energy production does not meet minimum targets. Due to poor operating results produced by previous owners, it is anticipated that the Fund will be responsible for payments of approximately \$69,000 for each year from 1998 to 2002.

(b) On April 17, 1998, \$20,779,916 plus accumulated interest were released from the funds held in escrow to acquire the following securities issued by the joint venture partners that developed the Long Sault Rapids facility in Ontario. The transactions were completed after the commissioning of the facility by Ontario Hydro.

The securities acquired were:

- (i) A subordinate note issued by the joint venture partners, interest at 14.14% compounded annually, to mature December 31, 2038, with blended payments of interest and principal. The note is subordinate to the main project financing of approximately \$45,000,000. \$ 2,000,000
- (ii) Royalty interests that provide for rights to cash flows. These interests range for periods of six to twenty years. 1,832,000
- (iii) A note issued by N-R Power & Energy Corp., which through ownership of partners to the project, hold a 50% undivided interest in the facility. The note bears interest at the rate of 9% per annum, with a maturity date of January 1, 2038. 6,567,762
- (iv) A note issued by APC, which through ownership of partners to the project, hold a 50% undivided interest in the facility. The note bears interest at the rate of 9% per annum, with a maturity date of January 1, 2038. 10,308,009

Both notes limit payments of principal and interest to specific percentages of after-tax cash flows.

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Subsequent Events - continued

(v) A deposit made to acquire shares of companies owned by N-R Power & Energy Corp. and companies owned by APC. The ownership of these companies will comprise a 58% equity interest in the Long Sault Rapids development. The effective date of transfer of ownership is expected to be January 1, 2038.

72,145

\$ 20,779,916

The various securities purchased provide the Fund with a 100% interest in the cash flows from the facility until 2013, 65% up to 2027, and 58% thereafter.

(c) APC has agreed to provide approximately \$1,200,000 additional working capital to the Fund in exchange for a reduction of similar amount in the Algonquin Note purchased by the Fund. The term to maturity of the note will be adjusted to June 30, 2004, with no changes made to the principal repayment schedule prior to this date. The letter of security that provides partial security for the note will also be reduced by a corresponding amount.

11. Commitments

Management Agreement with Related Party

The Fund has entered into a management agreement with Algonquin Management Inc. The management services to be provided include advice and consultation concerning business planning, support, guidance and policy making, and general management services. The management agreement is for an initial ten year term to expire December 31, 2008, with the term to be renewed for successive five year periods.

Algonquin Management Inc. is to receive the following fees in addition to reimbursement of reasonable out-of-pocket expenses:

- (1) a quarterly fee of US\$22,645 adjusted annually for changes to the Canadian Consumer Price Index;
- (2) a fee based on the total energy production from all facilities in which the Fund has an interest; and
- (3) an incentive fee equal to the aggregate of 10% of the distributable cash per trust unit in excess of \$0.925 per trust unit and up to \$1.00 per trust unit and 25% of the distributable cash per trust unit in excess of \$1.00 per trust unit.

During 1997, management fees of \$6,338 were incurred.

Operations Supervisory Agreement with Related Party

The Fund has entered into an operations supervisory agreement with Algonquin Power Systems Inc. The operations supervisory services to be provided include the planning of capital repairs, compliance monitoring for environmental permits and administration of power purchase agreements.

Commitments - continued

The operations supervisory agreement is for an initial term of ten years to expire on December 31, 2008 with the term to be renewed for successive five year periods.

Algonquin Power Systems Inc. is to receive a fee of US\$45,290 per quarter adjusted annually for the change in the Canadian Consumer Price Index. During 1997, operations supervisory fees of \$6,338 were incurred.

Direct Operations Contract with Related Party

Each of the operating entities has entered into a direct operations contract with Algonquin Power Systems Inc. The direct operations contracts provide for the day to day services required to operate and maintain the hydroelectric facility. Payments under these contracts typically have a fixed fee and variable component. The variable fee is either linked to gross revenue or gross revenue less direct operating costs. It is estimated that on an annual basis the Fund will pay approximately \$1,000,000 to Algonquin Power Systems of which \$400,000 will be expensed in the statement of operations and the remaining \$600,000 will be netted against cash flows to be received from Trafalgar and Long Sault. During 1997, the Fund incurred \$10,614 in direct operating contract expenses which are included in the operating expenses on the statement of operations. The Trafalgar operations also incurred \$4,615 of expenses with Algonquin Power Systems Inc. which reduced the cash flows received by the Fund.

Land and Water Leases

Each of the operating entities has entered into agreements to lease either the land and/or the water rights for the hydroelectric facility or to pay in lieu of property tax an amount based on water production. These payments typically have a fixed and variable component. The variable fee is generally linked to actual power production or gross revenue. It is estimated that on an annual basis the Fund is committed to pay approximately \$600,000 of which \$300,000 will be expenses in the statement of operations and the remaining \$300,000 will be netted against cash flows to be received from Trafalgar and Long Sault. During 1997, the Fund incurred \$6,232 in respect of these agreements.

**NOTES
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12. Distributions

Distributable income, as defined in the Trust Indenture, is distributed to unitholders of record on the last day of each calendar quarter on or before the 15th day of the following calendar quarter. Since the Fund did not have any distributable income at December 31, 1997, no distributions were made. In determining the annual distribution for 1998, the deficit cash position of \$837,132 will first need to be recovered. The deficit cash position is determined as follows:

Net loss	\$ (2,430,500)
Add: Portion of debt prepayment cost not currently payable	1,564,547
Amortization of capital assets	<u>28,821</u>
	<u>\$ (837,132)</u>

Subsequent to year end, the Trustees declared a distribution of \$0.175 per unit to unitholders of record on March 31, 1998. The total distribution in the amount of \$1,405,560 was paid on April 15, 1998.

Unitholder Information

Annual Meeting

The annual meeting of unitholders of the Algonquin Power Income Fund will be held in the Québec Room at the Royal York Hotel, 100 Front Street, Toronto, Ontario, at 4:00 p.m. on Monday June 22, 1998.

Trust Units

As of December 31, 1997, the Algonquin Power Income Fund had 8,031,775 Trust Units issued and outstanding.

The Trust Units are listed and traded on the Toronto and Montreal stock exchanges in Canada. The symbol for the Income Fund is APF.UN.

Distributions

Unitholders are entitled to receive quarterly cash distributions.

No distributions were made for 1997.

Auditors

The auditors of the Algonquin Power Income Fund are KPMG, Chartered Accountants, Commerce Court West, Suite 3300
P.O. Box 31, Station Commerce Court
Toronto, Ontario M5L 1B2

Registrar and Transfer Agent

The registrar and transfer agent for the Trust Units of the Algonquin Power Income Fund is the CIBC Mellon Trust Company with its head office at 320 Bay Street, P.O. Box 1, Toronto, Ontario M5H 4A6.

Corporate Information

Trustees

A. Stephen Probyn - Chairman

President, Probyn & Company

R. Ian Bradley

Independent Consultant

George L. Steeves

President, Cumming & Cockburn Limited

Algonquin Management Inc.

Chris K. Jarratt

Director and Chief Executive Officer

Ian E. Robertson

Director and Chief Financial Officer

John M.H. Huxley

Director

David C. Kerr

Director

Head Office

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