

ALGONQUIN POWER
INCOME FUND

Annual Report
December 31, 1998

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Profile

Algonquin Power Income Fund (the "Fund") is an unincorporated open-ended trust that was established under the laws of Ontario in September 1997. The Fund was created to acquire a direct or indirect equity interest in hydroelectric generating facilities. The Fund completed an initial public offering of Trust Units on December 23, 1997 and completed a second offering of Trust Units on July 7, 1998. The Fund currently owns a direct or indirect equity interest in 29 hydroelectric generating facilities located in Ontario (5), Québec (6), Newfoundland (1), New York (9), New Hampshire (7) and Vermont (1). The electricity from each facility is sold pursuant to power purchase contracts with various provincial and state utilities.

The Fund makes quarterly payments of distributable cash derived from its facilities to the maximum extent possible. Distributable cash includes all interest, lease payments and dividends and other income or return of capital.

As at December 31, 1998, the Fund had 14,090,472 Trust Units outstanding. The Trust Units trade on the Toronto Stock Exchange and the Montreal Exchange under the symbol APF.UN.

The Fund is governed by three independent trustees elected annually by the unitholders. The Fund is managed by Algonquin Management Inc., and the Fund's hydroelectric generating facilities are operated by Algonquin Power Systems Inc. The Trust Units are qualified investments under the Income Tax Act (Canada) for trusts governed by RRSPs, RRIFs and DPSPs and are not considered foreign property of such plans.

**REPORT TO
UNITHOLDERS**

I am pleased to present your Fund's Annual Report for the year ended December 31, 1998.

This year, your Fund achieved one of its major goals: growth. In February, the Fund successfully acquired the Belleterre and Ste-Brigitte facilities which are located in Québec. In April, the Fund acquired its interests in the Long Sault facility in Ontario shortly after the facility was commissioned. With the successful issue of additional Trust Units in July, the Fund acquired an additional 12 hydroelectric generating facilities located in Québec, New York and New Hampshire. The Rattle Brook facility was completed in the fall of 1998 and the fund's partnership interest in this Newfoundland generating facility was acquired on December 31, 1998.

The Fund now owns a direct or indirect equity interest in 29 generating facilities. Importantly, the additional facilities increase the Fund's commercial, political, hydrologic and geographic diversity. The Fund is committed to continue this growth strategy and has identified several excellent acquisition opportunities that it expects to complete in the near future.

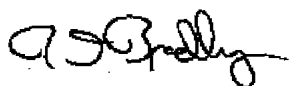
In 1998, the Fund declared four quarterly payments to unitholders totalling \$0.835 per Trust Unit. Distributions to unitholders were below forecast due to lower than average water flows experienced in northeastern North America, where the fund's generating facilities are located. The impact of the lower flows was somewhat mitigated by the US dollar exchange rate which provided a benefit to the Fund's cash position. There is no reason to believe that the abnormally dry conditions experienced in 1998 will continue in 1999.

In December 1998, the unitholders approved a special resolution allowing the Fund to borrow for the purpose of acquisitions. Obtaining a line of credit will provide greater flexibility for the Fund to make acquisitions when opportunities arise as long as the acquisition guidelines adopted by the Trustees are met.

We were pleased to appoint Mr. Ken Moore as a Trustee of the Fund. Mr. Moore brings significant experience in project finance relating to waterpower projects. The Fund's previous Trustee, Mr. Stephen Probyn, has accepted an appointment to the Board of Directors of Algonquin Power Fund (Canada) Inc. where he continues to provide advice and direction to the Fund's Trustees and the Fund's manager, Algonquin Management Inc.

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



(Signed) Ian Bradley
Chairman

The Consolidated Balance Sheet as at December 31, 1998, the Consolidated Statement of Operations and Deficit and the Consolidated Statement of Cash Flows reflect the results of the Fund's operations for the twelve months ended December 31, 1998. The comparative numbers reflect the results of the Fund's operations for the period from the date of formation of the Fund pursuant to the Declaration of Trust dated September 8, 1997 to December 31, 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 completed its second offering of 6,058,697 trust units at a price of \$10.65 per unit on July 7, 1998, raising \$58.7 million net of issue costs.

The Fund utilized the net proceeds of its first offering to acquire a direct or indirect equity interest in 17 hydroelectric generating facilities, and the net proceeds of its second offering to acquire a direct or indirect equity interest in an additional 12 facilities. The 29 facilities are located in Ontario (5), Québec (6), Newfoundland (1), New York (9), New Hampshire (7) and Vermont (1). The acquisition of the interest in the Newfoundland facility was completed on December 31, 1998.

As part of the initial public offering, the Fund also acquired a note issued by Algonquin Power Corporation Inc. ("APC"), a company wholly-owned by the shareholders of the Fund's manager, Algonquin Management Inc. (the "Manager"), for \$7.8 million.

Operating Results

For the twelve months ended December 31, 1998, the 28 hydroelectric facilities owned directly or indirectly by the Fund during the year generated total revenues of \$17.4 million. The Fund recorded these revenues as income from energy sales of \$4.7 million, interest income and income from participation agreements of \$3.5 million and receipt of principal on notes of \$3.8 million. Cumulatively, these cash flows represent 86% of the amounts forecasted.

Actual revenues from energy sales were lower than forecast largely as a result of lower than average water flows resulting from abnormally low amounts of rainfall in the region. Offsetting the impact of water flows has been the favourable US exchange rate compared to the rate utilized in the forecast.

Expenses of the Fund continue to be in line with the forecast.

Financial Condition

As at December 31, 1998, the Fund has a working capital deficit of \$2.0 million, of which \$1.9 million is the current portion of long-term liabilities. Payment of these long-term liabilities will be funded through 1999 cash flows.

In 1998, APC provided \$1.3 million to eliminate the working capital deficit that existed at December 31, 1997. This was funded by a reduction in the principal

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

amount of the APC note. The reduction in the note will not have an impact on the Fund's distributable cash until 2004, as the principal repayment schedule has not been adjusted until this time.

The costs of issue of both offerings were above the amounts forecasted. APC, as promoter of the offerings, determined that these excess costs were to be for its account. Accordingly, the purchase price of a facility sold by APC to the Fund was reduced by \$1.3 million. An APC demand note was issued to the Fund in payment of this amount.

Risk Management

Due to the Fund's ownership of hydroelectric 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 the Manager and the operations supervisory fees payable to Algonquin Power Systems Inc. are in US dollars. As well, the principal repayments on certain promissory notes are payable in US dollars. Together, this transfers much of the foreign exchange rate risk to the APC 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 the year 1900 (known as the "Y2K" problem). The Manager has undertaken an analysis of this potential problem as it relates to the Fund's business.

The electronic date stamped equipment utilized in the functioning and operation of the Fund's hydroelectric generating facilities is limited to electronic control systems. Upon loss of these control systems, the facilities will either be automatically or manually shut down, resulting in the loss of production of electricity. The Manager believes that there is a very low probability of such losses occurring. All electronic control systems are currently being tested and where required, Y2K compliant software is being obtained from vendors. All testing and remediation programs are scheduled to be completed by the end of September 1999. The budget for this work is \$110,000, which amount will be expensed as incurred.

The commercially provided general accounting, administration and data collection systems utilized by the Fund may suffer from the Y2K problem. Testing of these systems is scheduled to be completed by the end of April 1999 at a nominal cost.

Energy production from the facilities may be curtailed in the event that the grid systems of the utilities to which power is delivered by the facilities are unable to receive power as a result of the Y2K problem. This problem may be mitigated by the "take or pay" nature of certain power purchase agreements with various utilities. The Manager has contacted such utilities and received

assurances that they are taking steps to become Y2K compliant. The facilities also obtain electricity from these utilities primarily for standard services, such as heating, lighting and ventilation. Where electricity is utilized for control functions within a facility, such functions are equipped with their own back-up power sources, which are maintained and tested on a scheduled basis.

Outlook

With the acquisition of the interest in the Newfoundland facility on December 31, 1998, the Fund has completed all of the acquisitions outlined in its most recent prospectus. The Fund will receive 100% of the cash flows from 28 of the generating facilities from January 1, 1999 and 45% of the cash flows from the Newfoundland facility.

During the first quarter of 1999, water flows were slightly above long term average conditions. If the current water flow conditions continue, the Fund expects to meet the forecasted revenues for the balance of the forecast period from January 1 to June 30, 1999.

The Trustees have also amended the distribution payment date for future distributions in order to match distribution payments to unitholders with actual energy sales for the quarter. The scheduled payment date of January 15, 1999 was changed to February 15, 1999 to allow for the forecasted December revenues to be included with this distribution payment.

**AUDITORS'
REPORT**

AUDITORS' REPORT TO THE UNITHOLDERS OF
ALGONQUIN POWER INCOME FUND

We have audited the consolidated balance sheets of Algonquin Power Income Fund as at December 31, 1998 and 1997 and the consolidated statements of operations and deficit and cash flows for the year ended December 31, 1998 and for the period from 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 audits.

We conducted our audits 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, 1998 and 1997 and the results of its operations and its cash flows for the year ended December 31, 1998 and for the period from September 8, 1997 to December 31, 1997 in accordance with generally accepted accounting principles.

KPMG

Chartered Accountants

Toronto, Canada

March 29, 1999

Algonquin Power Income Fund
 Consolidated Balance Sheets
 December 31, 1998 and 1997
 (thousands of Canadian dollars)

**CONSOLIDATED
 BALANCE
 SHEETS**

Assets		
	1998	1997
Current assets		
Cash and cash equivalents	\$ 2,124	\$ 418
Amounts receivable	2,680	535
Notes receivable – current portion (note 4)	1,300	152
Prepaid expenses	168	24
	6,272	1,129
Notes receivable (note 4)	59,539	16,852
Participation and other interests (note 5)	6,727	-
Funds in escrow (note 3)	-	41,554
Capital assets, net of amortization (note 6)	62,558	18,376
Deferred foreign exchange loss	-	37
	\$135,096	\$ 77,948
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,086	\$ 1,275
Due to Algonquin group of companies	2,138	1,149
Cash distribution payable	3,170	-
Current portion of long-term liabilities (note 7)	1,922	-
	8,316	2,424
Long-term liabilities (note 7)	2,836	4,144
Unitholders' Equity		
Trust units (note 2)	132,461	73,811
Deficit	(8,517)	(2,431)
	123,944	71,380
Commitments (note 10)	\$135,096	\$ 77,948

See accompanying notes to the consolidated financial statements

Approved by the Trustees:



"Kenneth Moore", Trustee



"George L. Steeves", Trustee

**CONSOLIDATED
STATEMENTS OF
OPERATIONS
AND DEFICIT**

Algonquin Power Income Fund
Consolidated Statements of Operations and Deficit
Year ended December 31, 1998 and
Period ended December 31, 1997
(thousands of Canadian dollars)

	1998	From Date of Declaration of Trust September 8, 1997 To December 31, 1997
Revenue		
Energy sales	\$ 4,711	\$ 44
Interest income and income from participation agreements	<u>3,492</u>	<u>91</u>
	8,203	135
Expenses		
Operating	1,818	22
Amortization	1,982	29
Debt arrangement and prepayment fees	-	2,259
Management fees	294	6
Operations supervisory fees	278	6
Administrative expenses	305	168
(Gain) loss on foreign exchange	(219)	2
	<u>4,458</u>	<u>2,492</u>
Earnings (loss) before interest expense	3,745	(2,357)
Interest expense	<u>550</u>	<u>74</u>
Net earnings (loss)	3,195	(2,431)
Deficit, beginning of period	(2,431)	-
Cash distributions (note 11)	<u>(9,281)</u>	-
Deficit, end of period	<u>\$ (8,517)</u>	<u>\$ (2,431)</u>
Net earnings (loss) per trust unit (note 12)	<u>\$ 0.29</u>	<u>\$ (0.30)</u>

See accompanying notes to the consolidated financial statements

Algonquin Power Income Fund
 Consolidated Statements of Cash Flows
 Year ended December 31, 1998 and
 Period ended December 31, 1997
 (thousands of Canadian dollars)

**CONSOLIDATED
 STATEMENTS
 OF CASH FLOWS**

	1998	From Date of Declaration of Trust September 8, 1997 To December 31, 1997
Operating activities		
Net earnings (loss)	\$ 3,195	\$ (2,431)
Items not affecting cash		
Amortization of capital assets	1,870	29
Amortization of participation interests	112	-
Amortization of note discount	(73)	-
Foreign exchange	(590)	-
Loss on early repayment of note payable	-	1,565
Cash generated from operations	<u>4,514</u>	(837)
Changes in non-cash operating working capital	<u>2,517</u>	1,741
	<u>7,031</u>	<u>904</u>
Financing activities		
Cash distributions	(9,281)	-
Issue of trust units	64,525	80,318
Expenses of trust units offerings	(5,875)	(6,507)
Issue of notes payable at date of acquisition	-	10,402
Repayment of long-term liabilities	(78)	(7,823)
	<u>49,291</u>	<u>76,390</u>
Investing activities		
Decrease (increase) in funds in escrow	41,554	(41,554)
Acquisition of notes receivable	(47,668)	(17,041)
Receipt of principal on notes receivable	3,756	-
Acquisition of operating entities	(45,433)	(18,281)
Acquisition of participation and other interests	(6,839)	-
	<u>(54,630)</u>	<u>(76,876)</u>
Effects of exchange rate changes on cash and cash equivalents		
	<u>14</u>	-
Increase in cash Cash and cash equivalents, beginning of period	1,706	418
	<u>418</u>	-
Cash and cash equivalents, end of period	<u>\$ 2,124</u>	<u>\$ 418</u>
Supplemental disclosures of cash flow information		
Cash paid during the year for interest	\$ 550	\$ 74
Cash paid during the year for income taxes	\$ -	\$ -

See accompanying notes to the consolidated financial statements

**NOTES
TO THE
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STATEMENTS**

Algonquin Power Income Fund

Notes to the Consolidated Financial Statements

December 31, 1998 and 1997

(in thousands of Canadian dollars except unit information or as otherwise noted)

Algonquin Power Income Fund (the "Fund") is an open-ended, unincorporated Trust established pursuant to the Declaration of Trust dated September 8, 1997, as amended, under the laws of the Province of Ontario. The Fund's principal business activity is the ownership, directly or indirectly, of hydroelectric generating facilities.

The Fund is managed by Algonquin Management Inc., a company wholly owned by the shareholders of Algonquin Power Corporation Inc. ("APC"). APC took the initiative in organizing the business and affairs of the Fund. A subsidiary of APC, Algonquin Power Systems Inc., operates the hydroelectric facilities on a day to day basis. 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 consolidated accounts of its wholly-owned subsidiary, Algonquin Power Fund (Canada) Inc., which owns the entities as detailed in note 15 of these consolidated financial statements.

All significant intercompany transactions and balances have been eliminated.

(b) Cash and cash equivalents

Cash and cash equivalents include cash deposited at banks and highly liquid investments with original maturities of 90 days or less.

(c) Capital assets

Capital assets, being land, hydroelectric generating facilities, hydro contract acquisition costs 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.

The costs attributable to the acquisition of power purchase agreements are being amortized on a 20% declining balance basis.

**NOTES
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STATEMENTS***Significant accounting policies - continued*

(d) 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.

(e) Recognition of revenue

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

Interest income from notes held and income from participation agreements and other interests is recorded as earned.

(f) 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.

(g) 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 Income 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.

(h) 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 periods 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 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.

**NOTES
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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 \$50 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 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	\$ 80,318
Costs of the issue		(6,507)
Balance as at December 31, 1997	8,031,775	73,811
July 7, 1998 issue	6,058,697	64,525
Costs of the issue		(5,875)
Balance as at December 31, 1998	<u>14,090,472</u>	<u>\$ 132,461</u>

3. Acquisitions

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

Generating facilities

The Fund acquired from APC the hydroelectric generating facility of the Donnacona project in Québec for a purchase consideration of \$10,402. The acquisition was financed through the issue of two notes to APC, a loan secured by the equipment in the amount of \$7,823 and a promissory note in the amount of \$2,579. There was a credit arrangement fee payable to APC in the amount of \$694 for the arrangement of the equipment loan. The fee was paid on December 31, 1998.

On December 23, 1997, the Fund utilized certain of the proceeds of its first trust unit offering to repay the equipment loan of \$7,823 in full. The repayment was subject to a prepayment fee of \$1,565. The Fund has issued a promissory note to APC in satisfaction of this fee.

In addition to the repayment of the equipment loan, the Fund acquired the following assets from the proceeds of its first offering on December 23, 1997:

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 of which \$691 represents a note acquired from APC. Details of the Trafalgar Notes are in note 4 - Notes receivable.

Acquisitions - continued

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

Other entities

Other entities acquired on December 23, 1997 were 100% of Société Hydro-Donnacona S.E.N.C., a Québec limited partnership, from APC, 100% of the outstanding shares of Marsh Hydropower Inc. and Marsh Hydropower (Trent Valley) Inc., companies incorporated under the laws of Ontario, and 100% of HDI Associates I, an Indiana Partnership.

The acquisitions have 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	\$ (125)
Land	151
Generating facilities	7,731
Licences	<u>122</u>
Cash consideration paid	<u>\$ 7,879</u>

On February 12, 1998, \$20,774 plus accumulated interest was released from funds held in escrow to acquire 100% of the outstanding shares of BCL Energy (Belletre) Inc. and BCL Energy (Ste-Brigitte) Inc., both companies incorporated under the laws of Canada. The acquisitions have been accounted for using the purchase method. The consideration paid by the Fund has been allocated to the net assets acquired as follows:

Generating facilities	\$20,024
Hydro contract acquisition costs	1,442
Due to Hydro Québec	<u>(692)</u>
Cash consideration paid	<u>\$20,774</u>

On April 17, 1998, \$20,780 plus accumulated interest was released from 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:

LSR Subordinate Note (see note 4 - Notes receivable)	\$ 2,000
Participation interests that provide the rights to cash flows (see note 5 -Participation and other interests)	1,832
LSR Nicholls Note (see note 4 - Notes receivable)	6,568
LSR Algonquin Note (see note 4 - Notes receivable)	10,308
A deposit made to acquire shares of companies owned by N-R Power & Energy Corp. and companies owned by APC (see note 5 - Participation and other interests)	<u>72</u>
	<u>\$20,780</u>

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Acquisitions - continued

The Fund utilized the net proceeds of its second offering on July 7, 1998 to acquire the following assets on the same day:

Notes receivable:

- (i) Notes issued by the National Bank of Canada at a cost of \$22,500. Details of the notes are in note 4 - Notes receivable.
- (ii) Note issued by APC (the "Glenford Note") at a cost of \$4,992, as general partner of Société en Commandite Chute Ford, a Québec limited partnership. Details of the Glenford note are in note 4 - Notes receivable.

Option:

The Fund purchased an option at a cost of \$750 to acquire APC's 100% interest in Société en Commandite Chute Ford. Details of the option are in note 5 - Participation and other interests.

Other entities:

The Fund acquired 100% of Avery Hydroelectric Associates, Hadley Falls Associates, and HDI III Associates, which are New Hampshire limited partnerships, 100% of Burt Dam Power Company and Hollow Dam Power Company, which are New York limited partnerships, 100% of Moretown Hydro Energy Company, a Vermont limited partnership, and 100% of the outstanding shares of Lakeport Hydroelectric Corporation, a New Hampshire corporation. These entities collectively own 5 generating facilities in New Hampshire, 2 in New York and 1 in Vermont.

The acquisition of these entities 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	\$ 73
Generating facilities	24,321
Licences	<u>265</u>
Cash consideration paid	<u>\$24,659</u>

On December 31, 1998, the Fund utilized the balance of the proceeds of the July 7, 1998 offering to acquire 100% of the outstanding shares of 10640 Newfoundland Limited, a company incorporated under the laws of Newfoundland, at a cost of \$4,185. 10640 Newfoundland Limited owns a 45% interest in Algonquin Power (Rattle Brook) Partnership which owns and operates the Rattle Brook hydroelectric generating facility in Newfoundland. Details of the investment are in note 5 - Participation and other interests.

4. Notes receivable

Principal balances due in Canadian dollars are:

	1998	1997
Trafalgar Notes (i)	\$ 6,769	\$ 9,150
LSR Notes (ii)	18,876	-
National Bank of Canada Notes (iii)	22,500	-
APC Notes (iv)	<u>12,694</u>	<u>7,854</u>
	60,839	17,004
Less: current portion	<u>1,300</u>	<u>152</u>
	<u>\$59,539</u>	<u>\$16,852</u>

(i) Trafalgar Notes

Notes issued jointly and severally by Trafalgar Power Inc., a Delaware corporation, and Christine Falls Corporation, a New York corporation.

	1998	1997
Trafalgar Class A Note - 9.75% secured note due February 10, 2003, principal amount of US\$3,956 (1997 - US\$5,914)	\$ 6,078	\$ 8,459
Trafalgar Class B Note - 6.10% secured note due December 31, 2010, principal amount of US\$15,800 (1997 - US\$15,800)	<u>691</u>	<u>691</u>
	<u>\$ 6,769</u>	<u>\$ 9,150</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, annual cash flow targets are determined and the resulting cash payments are 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. The Fund received \$192 in 1998 (1997 - nil) from this 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 acquire 75% of the equity value of the facilities upon repayment of the Notes, without further payment.

(ii) LSR Notes

Notes issued by the joint venture partners who developed the Long Sault Rapids hydroelectric generating facility.

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**NOTES
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Notes receivable - continued

LSR Subordinate Note	
A subordinate note, interest at 14.14% compounded annually, due December 31, 2038, with blended monthly payments of principal and interest.	\$ 2,000
LSR Nicholls Note	
A participating note issued by N-R Power & Energy Corp., which through ownership of partners to the project, holds a 50% undivided interest in the facility. The note bears interest at 9% per annum with a maturity date of January 1, 2038.	6,568
LSR Algonquin Note	
A participating note issued by APC, which through ownership of partners to the project, holds a 50% undivided interest in the facility. The note bears interest at 9% per annum with a maturity date of January 1, 2038.	<u>10,308</u>
	<u>\$18,876</u>

The LSR Subordinate Note is subordinate to the main project financing of \$45,000. The LSR Nicholls and LSR Algonquin Notes are subordinate to the main project financing, the LSR Subordinate Note, and the participation interests also acquired by the Fund. The LSR Nicholls and Algonquin Notes are structured as participating debt with payments of interest and principal only being made from available cash flows of the Long Sault Rapids generating facility.

(iii) National Bank of Canada Notes

SLI Saint-Alban Note - 5% secured note, payable on demand	\$15,000
SLI Rawdon Note - 5% secured note, payable on demand	<u>7,500</u>
	<u>\$22,500</u>

The notes are secured by a security interest in favour of the National Bank of Canada of the rights held by the owners of the assets of the Saint-Alban and Rawdon generating facilities, and in the power purchase agreements with Hydro Québec, and other lease agreements.

APC has entered into purchase agreements with the owner of these facilities whereby the Fund will acquire the generating facilities and title to the power purchase agreements and other agreements. The Saint-Alban purchase agreement is expected to close approximately May 1, 2001, and will be completed by the retirement of the SLI Saint-Alban Note. The Rawdon purchase agreement is expected to close June 1, 1999, and will be completed by the retirement of the SLI Rawdon Note. The National Bank of Canada will release the security interest in each of the facilities upon the retirement of the corresponding note.

Notes receivable - continued

The Fund has entered into interim operations agreements with the owner of these facilities whereby the Fund will operate the facilities during the term of these notes. The Fund is entitled to all net cash flows from the facilities after payment of interest and payment of the operations services.

(iv) APC Notes

	1998	1997
APC Note - 9.25% secured note due January 1, 2005, note to be repaid in scheduled principal repayments over its term.	\$ 6,402	\$ 7,854
APC Glenford Note - 8.50% subordinate note due July 1, 2023, note to be repaid from available cash flows.	4,992	-
APC Demand Note - 5.50% note, unsecured, payable on demand.	<u>1,300</u>	<u>-</u>
	<u>\$12,694</u>	<u>\$ 7,854</u>

The APC Note is secured by a letter of credit in the amount of \$2,200 (1997 - \$3,500) and an assignment of all amounts owing by the Fund in respect of the \$2,579 promissory note payable to APC, and the guarantee of Algonquin Power Systems Inc.

The Glenford Note is subordinate to the senior project debt of \$6,038. It is secured by a first charge security interest in favour of the Fund over a debt reserve fund created by the partnership operating the Glenford facility.

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5. Participation and other interests

All participation and other interests were acquired in 1998.

Securities of the joint venture partners who developed the Long Sault Rapids generating facility:

Participation interests provide rights to cash flows from 1999 through to 2019.	
Gross book value	\$ 1,832
Less: accumulated amortization	<u>112</u>
	1,720

Deposits to acquire shares of companies owned by N-R Power & Energy Corp. and APC. Ownership of these companies will comprise a 58% equity interest in the facility. The effective date of transfer of ownership is expected to be January 1, 2038	<u>72</u>
	1,792

Option:

Option to acquire 100% partnership interest in Société en Commandite Chute Ford from APC for the Glenford facility. The option is exercisable after the repayment of the Glenford Note, but no earlier than June 2009, for \$1,500 payable in 10 annual installments.	750
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Equity:

100% of the outstanding shares of 10640 Newfoundland Limited, which owns a 45% interest in the Algonquin Power (Rattle Brook) Partnership. The partnership owns and operates the Rattle Brook hydroelectric generating facility in Newfoundland.	<u>4,185</u>
	<u>\$ 6,727</u>

6. Capital assets

	1998		1997	
	Cost	Accumulated amortization	Net book value	Net book value
Land	\$ 151	\$ -	\$ 151	\$ 151
Generating facilities	62,521	1,589	60,932	18,140
Hydro contract acquisition costs	1,442	288	1,154	-
Licences	349	28	321	85
	<u>\$ 64,463</u>	<u>\$ 1,905</u>	<u>\$ 62,558</u>	<u>\$ 18,376</u>

7. Long-term liabilities

	1998	1997
Notes payable to APC, unsecured		
10% per annum, to mature December 31, 2000, with scheduled quarterly principal payments in 1999 and 2000	\$ 2,579	\$ 2,579
9% per annum, to mature December 31, 2000, with scheduled quarterly principal payments in 1999 and 2000	<u>1,565</u>	<u>1,565</u>
	4,144	4,144
Amounts due to Hydro Québec	<u>614</u>	-
	<u>\$ 4,758</u>	<u>\$ 4,144</u>
Principal payments due in the next five years are:		
1999		\$ 1,922
2000		2,538
2001		166
2002		65
2003		<u>67</u>
		<u>\$ 4,758</u>

8. Financial instruments

The carrying amount of the Fund's cash and cash equivalents, amounts receivable, accounts payable and accrued liabilities, due to the APC group of companies and cash distributions payable approximate fair value due to the short term nature of these financial instruments.

The carrying amount of the Fund's notes receivable and participation and other interests approximate fair value due to the fact that the notes have been 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 long-term liabilities approximate fair value based on current interest rates offered to the Fund for debt of similar terms and maturities.

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9. Income taxes

The Fund's subsidiaries have accumulated tax losses available to offset taxable income in future years in the amount of approximately \$774. The tax benefit of these losses has not been recorded in these financial statements. These tax losses expire as follows:

Canadian subsidiaries

2004	\$ 78
2005	414
	<u>492</u>

US subsidiaries

2012	31
2013	251
	<u>282</u>
	<u>\$ 774</u>

10. Commitments

Management Agreement

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, 2007, 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\$23, increased to US\$36 on July 7, 1998 for the additional facilities under management, 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 1998, management fees of \$294 (1997 - \$6) were incurred.

Operations Supervisory Agreement

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

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Commitments - continued

environmental permits and administration of power purchase agreements. The operations supervisory agreement is for an initial term of ten years to expire on December 31, 2007 with the term to be renewed for successive five year periods.

Algonquin Power Systems Inc. is to receive a fee of US\$45 per quarter, increased to US\$54 for the additional facilities to operate as of July 7, 1998, adjusted annually for the change in the Canadian Consumer Price Index.

During 1998, operations supervisory fees of \$278 (1997 - \$6) were incurred.

Direct Operations Contract

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.

The Fund incurred \$732 during 1998 (1997 - \$11) in direct operating contract expenses for the facilities owned directly. For the facilities that generate interest income and income from participation agreements, there were direct operating contract expenses of \$945 in 1998 (1997 - \$6).

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 power production. These payments typically have a fixed and variable component. The variable fee is generally linked to actual power production or gross revenue. The Fund incurred \$275 during 1998 (1997 - \$6) in respect of these agreements for the facilities owned directly. For the facilities that generate interest income and income from participation agreements, there were land and water lease payments of \$102 in 1998 (1997 - nil).

11. Cash 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 45th day of the following calendar quarter. No distributions were paid in 1997, as the Fund only commenced operations with the initial acquisitions made on December 23, 1997.

Distributions declared by the Trustees in 1998 were as follows:

	Per Unit
First quarter	\$ 0.175
Second quarter	0.235
Third quarter	0.200
Fourth quarter	0.225
	<u>\$ 0.835</u>

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12. Net earnings (loss) per trust unit

Net earnings (loss) per trust unit has been calculated using the weighted average number of units outstanding during the year. The weighted average number of units outstanding for 1998 was 10,969,828 (1997 - 8,031,775).

13. Segmented information

The Fund's only operation is the ownership and management of hydroelectric generating facilities.

	1998	1997
Revenues		
Canada	\$ 5,023	\$ 99
United States	<u>3,180</u>	<u>36</u>
	<u>\$ 8,203</u>	<u>\$ 135</u>
Capital Assets		
Canada	\$35,381	\$15,125
United States	<u>27,177</u>	<u>3,251</u>
	<u>\$62,558</u>	<u>\$18,376</u>

Revenues are attributable to the two countries based on the location of the underlying generating facilities.

All revenues, either directly through energy sales or indirectly through income and participation agreements, are earned from contracts with large public utilities. The following utilities contributed more than 10% of these total revenues in 1998: Niagara Mohawk Power Corporation-41%, Ontario Hydro-28%, and Hydro Québec-22%. The Fund has mitigated its credit risk to the extent possible by selling energy to these large utilities in various North American locations.

14. Year 2000 uncertainty

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using the year 2000 is processed. In addition, similar problems may arise in some systems that use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failures that could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Fund, including those related to the efforts of customers, suppliers or other third parties, will be fully resolved.

15. Subsidiaries and partnership interests

The consolidated financial statements include the accounts of Algonquin Power Fund (Canada) Inc. , which wholly owns the following entities:

Canadian Subsidiaries and Partnership Interests

Marsh Hydropower Inc. *
 Marsh Hydropower (Trent Valley) Inc. *
 BCL Energy (Belleterre) Inc. **
 BCL Energy (Ste-Brigitte) Inc. **
 Société Hydro-Donnacona S.E.N.C. Partnership
 Donnacona Holdings Inc.
 10640 Newfoundland Limited.

* Amalgamated with Algonquin Power Fund (Canada) Inc. on January 1, 1998.

** Amalgamated with Algonquin Power Fund (Canada) Inc. on January 1, 1999.

U.S. Subsidiaries and Partnership Interests

Algonquin Power Fund (America) Inc.
 Algonquin Power Fund (America) Holdco Inc.
 Lakeport Hydroelectric Corporation
 Avery Hydroelectric Associates Partnership
 Burt Dam Power Company Partnership
 Hadley Falls Associates Partnership
 HDI I Associates Partnership
 HDI III Associates Partnership
 Hollow Dam Power Company Partnership
 Moretown Hydro Energy Company Partnership

The Fund through its ownership of 10640 Newfoundland Limited owns a 45% interest in Algonquin Power (Rattle Brook) Partnership. This investment is accounted for using the equity basis of accounting.

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Corporate Information

Trustees

Kenneth Moore

Managing Partner, NewPoint Capital Partners Inc.

R. Ian Bradley

Vice-President of Finance and Administration, Dylex Limited

George 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

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Stock Exchanges

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Montreal Exchange

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