



**Q1**

**REPORT**

*Three Months Ended June 30, 2004*

## MESSAGE FROM THE CEO

I am very pleased to report the results of the first quarter ended June 30, 2004 of Energy Savings Income Fund's fiscal 2005. This quarter saw the beginning of what will be an exciting new chapter for Energy Savings, our expansion into major new markets outside Ontario. While this period saw only the beginning of our ramp-up in Illinois and Quebec, the early results in these markets exceeded expectations and gives us grounds for optimism.

Gross Customer Additions	First Quarter	Annual Target	% Realised
Gas			
Ontario	32,000	100,000	32%
New Markets – Canada	9,000	60,000	15%
Illinois	5,000	50,000	10%
Electricity			
Ontario	23,000	50,000	46%
<b>Total</b>	<b>69,000</b>	<b>260,000</b>	<b>27%</b>

We passed an important milestone in the quarter with the addition of our one millionth long term customer. We surpassed our own most optimistic expectations in the brief time it has taken us to reach this point. Given the new markets available to us, we fully expect to continue to grow.

The table below shows the consistency of our marketing efforts. There is no evidence of saturation in any of our markets. With the possible reopening of at least a portion of the Ontario retail electricity market in early 2005, what we expect to be flat to slightly declining sign-ups in that sector could actually represent a further customer growth opportunity by Q4.

### Gross Customer Additions (Aggregated)

Fiscal 2005	Q1	Q2	Q3	Q4	YTD
Gas					
Ontario	32,000				<b>32,000</b>
New Markets – Canada	9,000				<b>9,000</b>
Illinois	5,000				<b>5,000</b>
Electricity	23,000				<b>23,000</b>
<b>Fiscal 2004</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
Gas	47,000	32,000	40,000	27,000	<b>146,000</b>
Electricity	51,000	32,000	24,000	14,000	<b>121,000</b>
<b>Fiscal 2003<sup>1</sup></b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
Gas	32,000	32,000	15,000	29,000	<b>108,000</b>
Electricity	35,000	61,000	56,000	8,000	<b>160,000</b>
<b>Fiscal 2002<sup>1</sup></b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
Gas	37,000	35,000	25,000	25,000	<b>122,000</b>

<sup>1</sup>Assumes 7% annual attrition. Quarterly attrition was not calculated prior to fiscal 2004.

We saw a significant decline in gas attrition through customer moves during the quarter. Attrition fell to 6% per annum from the 10% experienced in recent quarters. Electricity attrition remained low at 4.5%. Management continues to monitor

attrition to see if our internal planning projection of 10% per year has reverted to the long term historical average of 7%.

Our gross margin was \$36.3 million for the quarter up 9% from Q1 of fiscal 2004. Premarketing distributable cash was \$28.0 million or \$0.26 per unit down from \$29.5 million or \$0.28 per unit in Q1 of fiscal 2004. We received no material margin or cash flow from our new markets during the quarter. The decline in distributable cash is due to an increase of 126% or \$4.5 million in our general and administrative costs (G&A) for the period. This G&A build-up was necessary to establish infrastructure for our expansion into Illinois, Quebec and British Columbia. With this infrastructure in place, we expect to see the same rapid payback on investment that we have seen in the Ontario gas and electricity markets.

With these new markets performing as expected, management remains comfortable that Energy Savings will meet or exceed our published customer aggregation targets for fiscal 2005. This would see us grow our customer base by a net of 15% year over year. As I have often said, as we grow our customer base, we grow our cash flow. As our cash flow grows, our distributions grow. Consistent with this, we have announced our 18<sup>th</sup> annual distribution rate increase, from \$0.835 per unit to \$0.865 per unit effective our September distribution paid in October. While the first quarter saw our payout ratio exceed 70% for the first time, our modeling shows that the customers added during the period will generate cash flow to bring the ratio back down in future quarters under our normal conservative assumptions. This increase means that our distribution rate is up 188% since our IPO 38 months ago, a track record unprecedented in the Income Trust and REIT sector.

Management also remains comfortable with the range of published analysts' estimates for fiscal 2005 and 2006. Each of these analysts has Energy Savings rated as a "Buy" or an "Outperform". These reports anticipate an acceleration of our growth rate as we build our sales forces in Illinois and Quebec and begin marketing in B.C.

As I have stated in past Quarterly and Annual Reports, our expansion into new markets will be pursued using a "slow but steady" approach. Newly deregulated markets do not run away. We are seeing solid results in each new market and we continue to monitor possible further expansion in the United States. As always, we will move cautiously and deliberately. At the same time, I am confident that the Energy Savings business model – "Aggressive growth, Conservative management" will continue to serve us as well as it has since our IPO.

I want to thank my fellow Unitholders for their continued support.

Yours sincerely,



**Rebecca MacDonald,**  
CHAIR & CHIEF EXECUTIVE OFFICER

# HIGHLIGHTS

## Continued strong customer aggregation

### Gas – Ontario

- 32,000 gross customer additions
- 32% of fiscal 2005 target after Q1

### Electricity – Ontario

- 23,000 gross customer additions
- 46% of fiscal 2005 target after Q1

### New Markets

- Five year fixed price product well received
- At or ahead of target based on early results

## Long-term customer base reaches 1,045,000 up from 993,000

## Infrastructure in place to pursue Illinois, Quebec and B.C. markets

## 16<sup>th</sup> distribution rate increase during the quarter

## 17<sup>th</sup> distribution increase to \$0.835 per unit effective the July distribution

## 18<sup>th</sup> distribution rate increase to \$0.865 per unit announced and to be effective the October payment

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## OVERVIEW

Energy Savings Income Fund ("Energy Savings" or the "Fund") is an open-ended, limited-purpose trust established under the laws of Ontario to hold securities and to distribute the income of its wholly owned subsidiaries: Ontario Energy Savings Corp. ("OESC"), Energy Savings (Manitoba) Corp. ("ESMC"), Energy Savings (Quebec) L.P. ("ESPQ"), ES (B.C.) L.P. ("ES (BC) L.P.") and U.S. Energy Savings Corp. ("USESC"), (collectively the "Company"). Through its subsidiaries and affiliates, Energy Savings markets natural gas to residential customers and small to mid-sized commercial businesses in Ontario, Manitoba and Illinois and solely to commercial customers in Quebec and British Columbia. Energy Savings also markets electricity to mid-sized commercial and small industrial Ontario customers.

The Fund meets the estimated energy requirements of its customers by purchasing matching volumes of gas and electricity. Customers eliminate their exposure to price escalations and the Fund locks in its margins by entering into long term, fixed price contracts.

All amounts in this Management's Discussion and Analysis ("MD&A") are in Canadian dollars.

The following analysis reflects the operating results of the Company for the three months ended June 30, 2004. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the three months ended June 30, 2004 and the audited consolidated financial statements and MD&A for the year ended March 31, 2004 included in the Fund's 2004 Annual Report to Unitholders.

Copies of financial data and other publicly filed documents are available through the internet on the Canadian Securities Administrators' System for Electronic Document Analysis and Retrieval (SEDAR) which can be accessed at [www.sedar.com](http://www.sedar.com).

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## FINANCIAL HIGHLIGHTS

FOR THE THREE MONTHS ENDED JUNE 30

(thousands of dollars except where indicated and per unit amount)

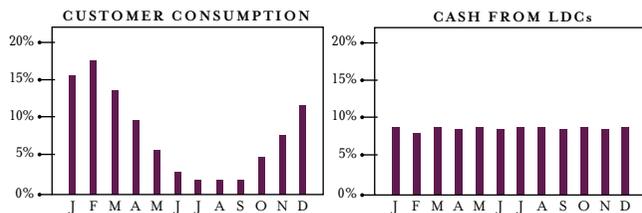
	2004		2003		Change
	\$	Per Unit	\$	Per Unit	
Amount available for distribution					
• Before selling expense	27,985	\$ 0.26	29,544	\$ 0.28	(5%)
• After selling expense	19,022	\$ 0.18	20,580	\$ 0.20	(8%)
Distributions	21,319	\$ 0.20	18,733	\$ 0.18	14%
General and administrative	8,133	\$ 0.08	3,604	\$ 0.03	126%
Payout ratio					
• Before selling expense	76%		63%		
• After selling expense	112%		91%		

## OPERATIONS

### Gas – Canadian Markets

Currently in Ontario, Manitoba, Quebec and British Columbia, Energy Savings is required to deliver gas to the local distribution companies (Enbridge Consumers Gas, Union Gas, Gaz Metro and Terasen, collectively the "LDCs") for its customers throughout the year. The Company receives cash from the LDCs as the gas is delivered.

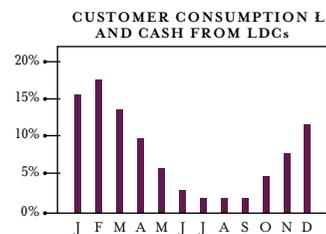
In Ontario, Quebec and British Columbia, the volume delivered for a customer remains constant throughout the year. The Company's accounting policy accounts for sales when the customer actually consumes the gas. Therefore, as is illustrated in the tables below, during the winter months gas is consumed at a rate which is greater than delivery and in the summer months gas is delivered in excess of gas consumed.



In Manitoba, the volume of gas delivered is not constant throughout the year. More gas is delivered in winter months in comparison to the spring and summer months. Consequently, cash received will be higher in the winter months.

### Gas – Illinois

The structure in the Illinois market is different than the Canadian markets. Energy Savings receives cash from Nicor (the "Illinois LDC") only when the customer has ultimately consumed that gas. Consequently, as illustrated in the table below, cash flow from operations will be greater in the Fund's third and fourth quarter assuming cash is received from the Illinois LDC in the same period as customer consumption. The Illinois gas market also requires the Company to bear the credit risk associated with customers' payment obligations. The default payment rate in the Nicor territory is approximately 1.1%. Energy Savings has instituted a credit approval process to ensure only customers with good payment history ultimately become customers of Energy Savings. It is also important to note that the majority of future U.S. markets Energy Savings may enter will function in a similar manner to Illinois.



### Electricity – Ontario

Electricity accounts are automatically balanced daily. In real-time, any supply greater than consumption is immediately sold off into the open market at the spot price, while any shortfall is immediately bought in the open market at the spot price. Under Energy Savings' aggregated contracts, customers bear all electricity balancing costs and retain any profit on balancing sales.

### Seasonally Adjusted Analysis

Presently, management believes the best basis for analysing both the Fund's operating results and the amount available for distribution is to focus on amounts actually received ("seasonally adjusted"). The following analysis eliminates this seasonal variance and illustrates the gas actually delivered to LDCs, the revenue received and associated margins. Management utilises this non-GAAP financial measure to determine future distributions. These non-GAAP financial measures do not have any standardised meaning prescribed by

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## OPERATIONS (cont'd)

### Seasonally Adjusted Analysis (cont'd)

GAAP and may not be comparable to similar measures presented by other issuers. As the Fund continues to further expand into other U.S. markets, seasonal working capital requirements will increase. This working capital requirement is directly attributable to the fact that the Company must purchase and deliver gas supply in advance of customer consumption and the receipt of cash from the LDCs. The Company continuously analyses future working capital requirements to address the Company's expected gas storage requirements and the timing of receipts from flowing customers.

No such seasonally adjusted analysis is required for electricity since electricity is consumed at the same time as delivery.

## RECONCILIATION OF REVENUE RECEIVED AND ASSOCIATED MARGIN

### FOR THE THREE MONTHS ENDED JUNE 30

(thousands of dollars)

	2004	2003
Gross margin per financial statements		
Gas	\$ 23,035	\$ 21,386
Electricity	8,723	5,009
Total	<u>\$ 31,758</u>	<u>\$ 26,395</u>
Opening unbilled revenues net of accrued gas accounts payable	7,085	12,295
Closing unbilled revenues net of accrued gas accounts payable	(2,591)	(6,942)
	<u>4,494</u>	<u>5,353</u>
Gross margin before balancing	36,252	31,748
Balancing allowance (Note 1)	—	1,500
Gross margin available for distribution	<u>\$ 36,252</u>	<u>\$ 33,248</u>

## AMOUNT AVAILABLE FOR DISTRIBUTION FOR THE THREE MONTHS ENDED JUNE 30

(thousands of dollars except per unit amount)

	2004	Per Unit (Note 2)	2003	Per Unit (Note 2)
Gross margin available for distribution	\$ 36,252		\$ 33,248	
Less:				
General and administrative	8,133		3,604	
Capital tax	250		250	
Other income (Note 3)	(116)		(150)	
	<u>8,267</u>		<u>3,704</u>	
Available for distribution before selling expenses	27,985	\$ 0.26	29,544	\$ 0.28
Selling expenses	8,963		8,964	
Amount available for distribution	<u>\$ 19,022</u>	\$ 0.18	<u>\$ 20,580</u>	\$ 0.20

## Reconciliation to Statement of Cash Flow

Cash flow from operations	\$ 16,493	\$ 16,814
Management incentive program	2,359	2,086
Income taxes (Note 4)	170	180
	<u>19,022</u>	<u>19,080</u>
Balancing allowance (Note 1)	—	1,500
Amount available for distribution	<u>\$ 19,022</u>	<u>\$ 20,580</u>

## Distributions

Management incentive program	\$ 2,359	\$ 2,086
Unitholder distributions	18,952	15,559
Unit appreciation rights distributions	8	—
	<u>21,319</u>	<u>17,645</u>
Non-cash distributions – Class B preference shares	—	1,088
Total distributions	<u>\$ 21,319</u>	<u>\$ 18,733</u>
	\$ 0.20	\$ 0.18

Note 1 – The balancing provision amounted to \$NIL for the three months ended June 30, 2004. Management believes that all prior period balancing for which the allowance was originally established has already occurred and a provision is no longer required. All current period balancing costs flow through the Statement of Operations.

Note 2 – Diluted average number of units amounted to 106.1 million for the three months ended June 30, 2004. For comparative purposes, the diluted number of units was 104.4 million for the three months ended June 30, 2003. All comparative unit and per unit data have been adjusted retroactively to reflect the impact of the unit split which was effective January 30, 2004.

Note 3 – Other income relates to interest earned on investments. This balance excludes any income/loss from changes in fair market values of derivative financial instruments which are marked to market.

Note 4 – Income taxes payable relate solely to large corporation tax. The Company does not have income taxes currently payable due to the deduction of certain acquisition costs.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## SUMMARY OF QUARTERLY RESULTS

(thousands of dollars except per unit amount)

	F2005		F2004	
	Q1	Q4	Q3	Q2
Sales per financial statements	\$ 186,073	\$ 312,905	\$ 181,803	\$ 106,096
Net income (loss)	4,141	21,255	3,872	(8,504)
Net income (loss) per unit – Basic	\$ 0.04	\$ 0.23	\$ 0.04	\$ (0.10)
Net income (loss) per unit – Diluted	0.04	0.22	0.04	(0.10)

### Amount available for distribution

• Before selling expense	\$ 27,985	\$ 28,828	\$ 30,881	\$ 27,138
• After selling expense	19,022	22,455	22,474	20,707

### Payout ratio

• Before selling expense	76%	70%	64%	69%
• After selling expense	112%	90%	88%	91%

	F2004		F2003	
	Q1	Q4	Q3	Q2
Sales per financial statements	\$ 132,300	\$ 225,125	\$ 130,689	\$ 58,817
Net income (loss)	769	21,740	1,460	(6,273)
Net income (loss) per unit – Basic	\$ (0.01)	\$ 0.28	\$ 0.01	\$ (0.10)
Net income (loss) per unit – Diluted	(0.01)	0.23	0.01	(0.10)

### Amount available for distribution

• Before selling expense	\$ 29,544	\$ 30,281	\$ 24,980	\$ 23,277
• After selling expense	20,580	25,875	16,436	16,274

### Payout ratio

• Before selling expense	63%	53%	61%	57%
• After selling expense	91%	62%	93%	82%

## SALES, GROSS MARGINS AND MARKETING RESULTS

FOR THE THREE MONTHS ENDED JUNE 30 (thousands of dollars)

Per Financial Statements	Sales	Cost of Sales	Gross Margin
<b>Gas</b>			
• 2004	\$ 125,931	\$ 102,896	\$ 23,035
• 2003	91,388	70,002	21,386
Increase	<u>34,543</u>	<u>32,894</u>	<u>1,649</u>

### Electricity

• 2004	\$ 60,142	\$ 51,419	\$ 8,723
• 2003	40,912	35,903	5,009
Increase	<u>19,230</u>	<u>15,516</u>	<u>3,714</u>

Total increase

\$ 53,773 \$ 48,410 \$ 5,363

### Seasonally Adjusted

	Sales	Cost of Sales	Gross Margin
<b>Gas</b>			
• 2004	\$ 143,348	\$ 115,819	\$ 27,529
• 2003	112,105	83,866	28,239
Increase (decrease)	<u>31,243</u>	<u>31,953</u>	<u>(710)</u>

### Electricity

• 2004	\$ 60,142	\$ 51,419	\$ 8,723
• 2003	40,912	35,903	5,009
Increase	<u>19,230</u>	<u>15,516</u>	<u>3,714</u>

Total increase

\$ 50,473 \$ 47,469 \$ 3,004

As noted above, sales have increased \$53.8 million (41%) on a financial statement basis and \$50.5 million (33%) on a seasonally adjusted basis for the quarter ended June 30, 2004 as compared to the prior comparative quarter. Financial statement margins have increased \$5.4 million (20%) and \$3.0 million (9%) seasonally adjusted for the same comparative period.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## FINANCIAL STATEMENTS – GROSS MARGIN

### Gas

Financial statement gas gross margin increased 8% year over year. Sales increased 38% primarily due to an increase in long term and acquired customers versus the previous comparative quarter; see "Customer Aggregation" for further details.

The increase in sales is greater than the increase in margin due to the acquisition of the Toronto Hydro and Union Energy customer contracts during fiscal 2004. Energy Savings acquired 20,000 long term customer contracts from Toronto Hydro Energy Inc. in July, 2003 and 20,000 long term customer contracts from Union Energy Inc. in October, 2003. As was expected at the time of the acquisition of these customers, they generate substantially less gross margin compared to customers normally aggregated by Energy Savings.

### Electricity

Electricity margins were \$8.7 million for the quarter, up from \$5.0 million (74%) over the prior comparative quarter. Electricity sales increased by 47%. The increase in sales was largely the result of the 41% year over year increase in long term customers. Margin increased by a higher percentage than sales because low-margin First Source customers acquired in Q1 2004 were a smaller proportion of the overall customer base. See "Customer Aggregation" for further details.

## SEASONALLY ADJUSTED – GROSS MARGIN

The Fund has separated the gross margin received from the LDCs (this number eliminates both seasonality and other weather variances) and the gross margin attributable to balancing activities (the approximate impact of weather variance for the period) in the quarter ended June 30, 2004 for the gas business. These components are added to electricity gross margin (electricity balancing costs are primarily passed on to the customer) and extraction revenue (sale of liquids extracted from gas) to equal total gross margin.

	F2005		F2004		
	Q1	Q4	Q3	Q2	Q1
Customer margins from LDCs	\$ 28,443	\$ 26,850	\$ 28,805	\$ 28,064	\$ 25,620
Balancing adjustments	(924)	(599)	(619)	(2,861)	1,017
Balancing allowance	–	750	–	250	1,500
Extraction revenue	10	33	106	148	102
<i>Total gas margins</i>	<u>27,529</u>	<u>27,034</u>	<u>28,292</u>	<u>25,601</u>	<u>28,239</u>
<i>Electricity margins</i>	<u>8,723</u>	<u>8,501</u>	<u>7,964</u>	<u>6,119</u>	<u>5,009</u>
<i>Total margin</i>	<u>\$ 36,252</u>	<u>\$ 35,535</u>	<u>\$ 36,256</u>	<u>\$ 31,720</u>	<u>\$ 33,248</u>

### Gas

On a seasonally adjusted basis, margins from long term customers were \$28.4 million, up from \$25.6 million (11%) in the prior comparative quarter. The increase in margins is primarily the result of an increase in customers of 18% offset by lower margins attributable to acquired customers. Total gas margins for the quarter (including balancing adjustments and extraction revenue) was \$27.5 million, down from \$28.2 million (3%) in the prior comparative quarter. Balancing adjustments for the quarter resulted in a charge to margins of \$0.9 million. The balancing costs were predominantly related to financial reconciliations with utilities to offset past over-deliveries as a result of warmer weather. Financial reconciliations with utilities represent the difference between money collected based on actual consumption versus money paid on deliveries. These reconciliations are performed on the annual anniversary of each customer contract.

### Electricity

Seasonally adjusted electricity margins for the year were \$8.7 million, the same as on a financial statement basis. Refer to "Financial Statements – Gross Margin" for details.

## DISTRIBUTABLE CASH

Premarketing distributable cash was \$28.0 million (\$0.26 per unit) down 5% from the \$29.5 million (\$0.28) realised in the comparable quarter. The decrease was due to a \$4.5 million increase (126%) in general and administrative costs versus the comparable quarter. This increase was due to the cost of establishing infrastructure for new markets in Illinois, Quebec and B.C. None of these markets contributed material cash flow during the period but represent Energy Savings' key growth markets for the future. See "General and Administrative Costs" and "Outlook".

Distributable cash after selling expenses was \$19.0 million (\$0.18 per unit) down from \$20.6 million (\$0.20 per unit) in the comparable quarter. The decrease was due to the higher general and administrative costs noted above.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## DISTRIBUTABLE CASH (cont'd)

The payout ratio was 76% on premarketing distributable cash, and 112% after marketing expenses. Management is comfortable with the QI payout ratios, although for the first time they were greater than our historical range of 60-70% and 90-100% respectively. Customers added during the period will generate cash flow in future periods, bringing the ratios back down to our normal range. Our overall payout of 112% resulted in a reduction of accumulated cash balances to \$36.0 million at quarter end from \$40.2 million at the end of the prior quarter. The Fund's accumulated cash balances were built in anticipation of its use in building infrastructure, funding working capital and aggregation of customers within new markets. Management is comfortable with the Fund's liquidity and believes it has adequate capital resources to fund both its growth and distributions going forward. See "Liquidity and Capital Resources".

## CUSTOMER AGGREGATION – RCE'S ADDED FOR THE THREE MONTHS ENDED JUNE 30

### Long Term Customers

Overall, the rate of customer aggregation in the quarter supports the Fund's ability to meet or exceed published targets on both a gross and net basis. Gross additions were 69,000 and net additions were 52,000. This level of customer aggregation was achieved in the quarter despite the fact that the new markets were still in the early ramp-up stage during the period.

The Fund's published targets for fiscal 2005 were gross additions of 260,000 and net additions of 160,000.

	Beginning	Additions	Attrition <sup>1</sup>	Failed to Renew <sup>2</sup>	Ending
Ontario	635,000	32,000	9,000	3,000	655,000
New Markets – Canada	10,000	9,000	1,000	–	18,000
Illinois	–	5,000	–	–	5,000
Gas	645,000	46,000	10,000	3,000	678,000
Electricity	348,000	23,000	4,000	–	367,000
Combined	993,000	69,000	14,000	3,000	1,045,000

<sup>1</sup> Attrition – Customers whose contracts were terminated primarily due to relocation -

<sup>2</sup> Failed to Renew – Customers who did not renew expiring contracts at the end of their term

Key terms: -

Long term Customers – Customers that management expects to retain -

RCE – Residential Customer Equivalent or the "Customer" -

In addition to the long term customers, Energy Savings has an additional 89,000 customers (50,000 gas and 39,000 electricity) which were acquired through various acquisitions of customer contracts. These customers are not expected to renew upon expiration of their current contract. These customers generate substantially less margin than typically realised on customers aggregated by Energy Savings. The contribution for gas customers not expected to renew was approximately \$65 per annum and \$50 per annum for each electricity customer not expected to renew. These customers have approximately two years remaining until the end of their contract.

A total of 17,000 Customers Not Expected to Renew were lost during the period through both attrition and non-renewal. This total was consistent with both the Company's expectations at the time of acquisition and past experience.

## MARKETING

### Ontario – Gas

The natural gas market remained receptive to the Energy Savings' five year fixed price offering during the quarter. In the quarter, gross additions of 32,000 customers represents a continued strong demand for long term gas contracts in Ontario. All Ontario gas customers signed during the period were matched with supply to generate margins at or above Energy Savings' \$170 per year gas target margin.

### Ontario – Electricity

Total gross electricity additions were 23,000, ahead of the aggregation rate needed to realise the Fund's published target of 50,000 gross additions for the year. During the quarter, Energy Savings only marketed electricity to larger commercial customers (consumption over 250,000 kWh). Certain large-volume customers aggregated skewed the total additions for Q1. Management believes that this level of aggregation will not necessarily be sustainable pending the possible reopening of a broader electricity market expected after the new year. All electricity customers signed during the period were matched with supply to generate margins at or above Energy Savings' \$100 per year target margin. See "Outlook" for potential electricity customer opportunities.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

### MARKETING (cont'd)

#### *New Markets – Canada*

This includes the aggregation of customers outside the province of Ontario, which presently includes Manitoba, Quebec and British Columbia. Energy Savings began offering its product in Manitoba in January 2003, in Quebec in April 2004 and in British Columbia in July 2004. Total gross additions for this group were 9,000 for the quarter. While the published annual target is 60,000 for the year, Quebec was still in the early stages of agent ramp-up and no customers were signed in B.C. during the quarter. To date, based on limited data, the acceptance of the five year fixed price gas offering in each market has been positive. Management is confident that it will attain its New Markets - Canada target of 60,000 RCEs gross additions for fiscal 2005. All gas customers signed during the period were matched with supply to generate margins at or above Energy Savings' \$170 per year target margin.

#### *New Markets – U.S.*

During the quarter, Energy Savings aggregated 5,000 RCEs in the State of Illinois. The initial product offering was directed to commercial customers. Energy Savings began offering its product to residential customers during the quarter. The number of sales agents has grown from approximately 18 at year end to approximately 40 as at June 30, 2004 reflecting increased selling activity. Based on current aggregation rates, management believes that the published 50,000 gross customer addition target for fiscal 2005 will be achieved. All Illinois gas customers signed during the period were matched with supply to generate margins at or above Energy Savings' \$120 per year Illinois target margin.

#### *Attrition*

Attrition in the natural gas customer book for the quarter was an annualised 6.0%, below the Company's planning basis of 10%. During the prior fiscal year, the Fund experienced attrition rates approximating 10% primarily attributable to the low mortgage rates and record number of house sales in Ontario, which resulted in increased customer moves. Attrition for the electricity customer book was an annualised 4.5% reflecting the fact that the majority of electricity customers are commercial, a group which has much lower propensity to move. Overall, the combined annual attrition for both gas and electricity was below the 10% customer attrition rate used for internal purposes. Management is

monitoring attrition to see if it has reverted to the long term historical average of 7% per annum.

### SELLING EXPENSE

Selling expenses, which primarily consist of one-time costs of signing new customers, were \$9.0 million for the three months ended June 30, 2004, consistent with the selling expense of the previous comparative quarter. Selling expenses remained constant even though fewer customers were aggregated than in the prior comparative quarter (69,000 vs. 84,000) because of the higher proportion of gas customers (more costly to aggregate) aggregated. The aggregation cost for each additional gas customer is approximately \$140 in Canada and \$90 in the U.S. versus \$85 for each additional electricity customer.

Management expects that average customer aggregation costs for Canadian natural gas customers will increase to approximately \$160 per new customer. Historically, the aggregation cost of \$140 per RCE included commissions paid to sales agents, incentive awards and costs of contract printing only. Management believes that the implementation of a name awareness advertising campaign plus other marketing expenditures including a more substantial outbound calling program will aid in "per-door-knocked" signings and increased customer reconfirmation rates going forward. The inclusion of the above costs in per customer selling expenses will increase the aggregation cost by approximately \$20/RCE.

Target aggregation costs for Ontario electricity and Illinois gas customers remain at \$85 and \$90 respectively.

### GENERAL AND ADMINISTRATIVE COSTS

General and administrative costs ("G&A") were \$8.1 million for the quarter. These costs represent an increase of 25% from the fourth quarter and 126% from the prior comparative quarter. The increase in G&A costs was primarily driven by the costs associated with the expansion into new markets, including Quebec, British Columbia and the United States. The costs associated with putting the necessary infrastructure and processes in place for these markets have largely been made in the fourth quarter of fiscal 2004 and the first quarter of fiscal 2005. The main increases in costs were in customer service, information technology and operations. Management believes that the infrastructure being put in place will support the Fund's continued growth into new markets. Accordingly, management's expectation is that G&A will be lower in Q2 than it was in Q1.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## GENERAL AND ADMINISTRATIVE COSTS *(cont'd)*

As in the past, G&A costs will fluctuate as the Fund continues to increase its existing customer base. Increased customer aggregation will result in the need to increase customer service staff and, to a lesser extent, information technology staffing to ensure the Fund maintains a high level of customer satisfaction.

## UNIT BASED COMPENSATION

In addition to the unit option plan, Energy Savings implemented a unit appreciation right plan as well as a deferred compensation plan during the period. The unit appreciation right plan grants unit appreciation rights (UARs) to certain senior officers and consultants. The deferred compensation plan grants deferred unit grants (DUGs) to all independent directors of OESC. The non-cash charge for these plans for the three months ended June 30, 2004 and 2003 amounted to \$0.4 million and \$1.6 million, respectively.

## MANAGEMENT INCENTIVE PROGRAM

Each of the holders of the Class A Preference Shares is entitled to receive, on a quarterly basis, a management bonus equal to the amount paid or payable to a Unitholder on a comparable number of units. Total paid during the quarter amounted to \$2.4 million.

## LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity and capital resources are funds generated from operations, the existing \$10.0 million credit facility and an ability to issue units. These resources are used to satisfy our capital resource requirements, growth in operations and payment of Unitholder distributions. During the quarter, cash inflow from operations totaled \$16.5 million, a slight decrease from the previous comparable quarter. The decrease was largely the result of increased general and administrative costs required for further expansion into new markets.

During the quarter, the primary uses of cash beyond selling costs included Unitholder distributions totaling \$18.6 million and general and administrative costs of \$8.1 million. These uses of cash are consistent with the overall business strategy of the Fund.

At June 30, 2004, the Fund had a cash balance of \$36.0 million. Our entry into new markets will require the utilisation of some of the Fund's accumulated cash resources to meet working capital requirements associated with selling costs and inventory storage. The Fund will ensure that the cash and credit facilities are sufficient to meet these needs.

Energy Savings purchased capital assets totaling \$1.6 million during the quarter compared to \$0.9 million in the three months ended June 30, 2003. The purchases were primarily for information technology systems supporting the Fund's entry into new markets.

At June 30, 2004, the Fund had a \$10.0 million credit facility. This operating line is primarily utilised to provide credit support to various suppliers. As at quarter end, OESC had provided letters of credit totaling \$7.1 million primarily in support of future commodity purchases.

In understanding the Company's liquidity requirements, it is important to note that customers aggregated in a quarter do not generate cash flow during that period. However, approximately 60% of an agent's commission payment is made following reaffirmation with the remaining 40% being paid after the customer begins flowing with Energy Savings.

The elapsed time between when a customer is signed to when first payment is received from the customer varies with each market. The time delays per market are approximately:

Ontario – Electricity	2-3 months
Ontario – Gas	4-6 months
Manitoba	3-6 months
Quebec	4-5 months
British Columbia	4-8 months
Illinois	2-3 months

These time periods reflect the time required by the different LDCs to enroll, flow commodity, bill the customer and remit the first payment to Energy Savings.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

## DISTRIBUTIONS

During the quarter, the Fund made distributions of \$21.3 million, including the management incentive program compared to \$18.7 million in prior comparative period, an increase of 14%. The payout ratio before marketing costs was 76% for the quarter and 63% for the prior comparative quarter. After marketing costs, the payout ratio was 112% for the quarter compared to 91% for the prior comparative year.

At the end of the quarter, the annual rate for distributions per unit was \$0.805, and was subsequently increased to \$0.835 effective for the distribution paid in July.

## BALANCE SHEET JUNE 30, 2004 COMPARED TO MARCH 31, 2004

As expected at the end of the quarter, customers had consumed more gas than was supplied to the LDCs for their use. Since the Fund is paid for this gas when delivered yet recognises revenue when the gas is consumed by the customer, the result on the balance sheet is the unbilled revenue amount of \$20.1 million and accrued gas accounts payable of \$17.5 million.

Other assets represent the estimated fair value of various derivative financial instruments for which hedge accounting in accordance with AcG-13, Hedging Relationships has not been applied. These assets are marked to market and any changes to the fair value are recorded in other income. Hedge accounting has been applied to the Fund's electricity fixed-for-floating swaps which represent the vast majority of derivative instruments in terms of notional value. The gains or losses on these swaps are recognised as a component of cost of sales when the hedged electricity costs are incurred. See "Fair Value of Derivative Instruments and Risk Management" for further details.

## CONTRACTUAL OBLIGATIONS

In the normal course of business, the Fund is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancelable.

Payments due by period (thousands of dollars)	Less than				
	Total	1 year	1 – 3 years	4 – 5 years	After 5 years
Property & equipment lease agreements	\$ 11,449	\$ 1,950	\$ 5,173	\$ 2,392	\$ 1,934
Marketing agreement obligations	6,123	2,041	4,082	–	–
Gas & electricity supply purchase commitments	1,894,090	467,327	1,269,127	157,636	–
	<u>\$ 1,911,662</u>	<u>\$ 471,318</u>	<u>\$ 1,278,382</u>	<u>\$ 160,028</u>	<u>\$ 1,934</u>

## FAIR VALUE OF DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT

Energy Savings hedges its obligations to deliver gas and electricity to its customers through entering physical and financial derivative instruments which lock in the cost of its supply. These derivative instruments currently consist of physical forwards, financial fixed-for-floating swaps, put and call options.

Effective April 1, 2004, the Company was required to implement an accounting standard that calls for the recognition of financial derivative instruments in the financial statements unless certain requirements for hedge accounting are fulfilled and documentation is maintained. If these requirements are fulfilled and adequate documentation is maintained by the Company, then the financial derivative instrument is eligible for hedge accounting and recognised at the same time as the revenue it was intended to hedge. If the requirements for hedge accounting are not met, the financial derivative is an economic hedge and the fair value of the financial instrument must be determined and recorded in the balance sheet. Differences between fair value for each reporting period are thereafter booked to the Statement of Operations as other income.

Energy Savings has primarily entered into financial derivative instruments that are eligible for hedge accounting. These continue to be recognised in the Statement of Operations when the related energy costs are incurred provided they continue to meet the requirements of the new standard. There are, however, some financial derivative instruments that do not qualify and are therefore only economic hedges. As at June 30, 2004, Energy Savings had booked \$466, the fair value of these economic hedges, in "Other assets" with the associated income recorded in "Other income".

The Company's physical derivative instruments are not captured by these new requirements and continue to be recognised at the time of delivery.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

August 6, 2004

### OUTLOOK

On June 15, 2004, the Ontario Ministry of Energy introduced in the Ontario Legislature, Bill 100, The Electricity Restructuring Act, 2004 which confirms the commitment of the Province of Ontario to ensure that consumers pay the true price of power. To the extent that the regulation of electricity moves to an Ontario Energy Board administered market-based pricing for the small business segment (1.5 million RCEs) and/or the residential market (4.0 million RCEs), Energy Savings, as the most active electricity marketer in the Province, stands to benefit through a much larger available market for its electricity offering. Management expects that any electricity customers made available by the new legislation will open for marketing in early 2005.

Energy Savings entered the B.C. market and began test marketing in July. Based on the test marketing to date, acceptance of Energy Savings' five year, fixed price product has been positive.

Energy Savings continues to actively monitor the progress of the deregulated markets in various jurisdictions including Alberta, Indiana, New York, Virginia and Maryland.

Energy Savings has been and remains a marketing company. While the Fund has more than one million customer equivalents under long term contracts at locked-in margins, its future results are dependent upon its ability to continue to add new customers both in Ontario and new markets. Management believes that these growth opportunities will continue to exist.

### TRUST UNITS OF THE FUND AND PREFERENCE SHARES OF OESC

As at August 6, 2004, the number of preference shares of OESC and Units of the Fund outstanding were 11,434,878 and 93,302,766, respectively, unchanged from the amount outstanding at June 30, 2004.

### FORWARD-LOOKING INFORMATION

This Management Discussion and Analysis contains certain forward-looking information statements pertaining to customer additions that are based on the Fund's current expectations, estimates, projections and assumptions that were made by management given recent experience and historical trends. Forward-Looking statements are based on current expectations that involve a number of risks and uncertainties, which could cause actual results to differ from those anticipated.

## CONSOLIDATED BALANCE SHEETS

(Unaudited - thousands of dollars)

	June 30, 2004	March 31, 2004
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	\$ 35,963	\$ 40,241
Restricted cash (Note 4) -	5,403	7,163
Accounts receivable	23,670	18,627
Gas in storage	114	-
Unbilled revenues	20,078	37,495
Prepaid expenses	2,552	1,803
	<b>87,780</b>	<b>105,329</b>
<b>GAS CONTRACTS</b> (less accumulated amortisation - \$161,517; 2004 - \$149,363)	78,576	90,730
<b>ELECTRICITY CONTRACTS</b> (less accumulated amortisation - \$1,157; 2004 - \$890)	4,181	4,448
<b>GOODWILL</b>	94,576	94,576
<b>CAPITAL ASSETS</b> (less accumulated amortisation - \$2,035; 2004 - \$1,702)	7,759	6,493
<b>OTHER ASSETS</b> (Note 2)	466	-
	<b>\$ 273,338</b>	<b>\$ 301,576</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 13,820	\$ 13,318
Customer rebates payable (Note 4)	5,403	7,163
Management incentive program payable	1,250	1,218
Unit distribution payable	6,494	6,103
Corporate taxes payable	155	485
Accrued gas accounts payable	17,487	30,410
	<b>44,609</b>	<b>58,697</b>
<b>FUTURE INCOME TAXES</b>	24,991	29,856
	<b>69,600</b>	<b>88,553</b>
<b>EQUITY</b>		
Preference shares of OESC (Note 5) -	\$ 28,587	\$ 29,078
Trust units (Note 6) -	171,164	177,323
Contributed surplus (Note 7) -	3,987	6,622
	<b>203,738</b>	<b>213,023</b>
	<b>\$ 273,338</b>	<b>\$ 301,576</b>

## CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

FOR THE THREE MONTHS ENDED JUNE 30

(Unaudited – thousands of dollars)

	2004	2003
UNITHOLDERS' EQUITY, BEGINNING OF PERIOD	\$ 177,323	\$ 208,078
Trust units exchanged	491	584
Trust unit options exercised	8,169	7,735
NET INCOME	4,141	769
DISTRIBUTIONS	(18,960)	(16,647)
CLASS B PREFERENCE DISTRIBUTIONS EXCHANGEABLE INTO UNITS	-	1,088
UNITHOLDERS' EQUITY, END OF PERIOD	<u>\$ 171,164</u>	<u>\$ 201,607</u>

## CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED JUNE 30

(Unaudited – thousands of dollars)

	2004	2003
<b>SALES</b>	\$ 186,073	\$ 132,300
<b>COST OF SALES</b>	154,315	105,905
<b>GROSS MARGIN</b>	<u>31,758</u>	<u>26,395</u>
<b>EXPENSES</b>		
General and administrative expenses	8,133	3,604
Capital tax	250	250
Selling expenses	8,963	8,964
Unit based compensation (Note 7)	435	1,627
Management incentive program	2,359	2,086
Amortisation of gas contracts	12,154	13,437
Amortisation of electricity contracts	267	199
Amortisation of capital assets	333	204
	<u>32,894</u>	<u>30,371</u>
<b>LOSS BEFORE OTHER INCOME</b>	(1,136)	(3,976)
<b>OTHER INCOME</b> (Note 2)	582	150
<b>LOSS BEFORE INCOME TAX</b>	(554)	(3,826)
<b>RECOVERY OF INCOME TAX</b>	(4,695)	(4,595)
<b>NET INCOME</b>	<u>\$ 4,141</u>	<u>\$ 769</u>
<b>Net income (loss) per unit</b> (Note 9)		
Basic	\$ 0.04	\$ (0.01)
Diluted	\$ 0.04	\$ (0.01)

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED JUNE 30

(Unaudited – thousands of dollars)

	2004	2003
<b>NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES</b>		
<b>OPERATING</b>		
Net income	\$ 4,141	\$ 769
<b>Items not affecting cash</b>		
Amortisation of gas contracts	12,154	13,437
Amortisation of electricity contracts	267	199
Amortisation of capital assets	333	204
Unit based compensation	435	1,627
Future income taxes	(4,865)	(4,775)
Other income (Note 2) -	(466)	-
	<u>7,858</u>	<u>10,692</u>
Adjustments required to reflect net cash receipts from gas sales	4,494	5,353
<b>Cash inflow from operations</b>	<u>16,493</u>	<u>16,814</u>
Changes in non-cash working capital	(5,702)	(838)
	<u>10,791</u>	<u>15,976</u>
<b>FINANCING</b>		
Exercise of trust unit options	5,099	5,226
Distributions paid to Unitholders	(18,569)	(15,078)
	<u>(13,470)</u>	<u>(9,852)</u>
<b>INVESTING</b>		
Purchase of capital assets	(1,599)	(854)
Acquisition of customer contracts	-	(5,973)
	<u>(1,599)</u>	<u>(6,827)</u>
<b>NET CASH OUTFLOW</b>	<u>(4,278)</u>	<u>(703)</u>
<b>CASH, BEGINNING OF PERIOD</b>	40,241	34,722
<b>CASH, END OF PERIOD</b>	<u>\$ 35,963</u>	<u>\$ 34,019</u>
<b>Supplemental Information</b>		
Interest paid	\$ 19	\$ 14
Income taxes paid	\$ 500	\$ 575

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – thousands of dollars except where indicated and per unit amount)

### 1. INTERIM FINANCIAL STATEMENTS

The unaudited interim consolidated financial statements do not conform in all respects to the requirements of Canadian generally accepted accounting principles for annual financial statements and should therefore be read in conjunction with the audited consolidated financial statements and notes thereto included in the Fund's annual report for fiscal 2004. The unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles applicable to interim consolidated financial statements and follow the same accounting policies and methods in their applications as the most recent annual financial statements, except as indicated in Note 2.

### 2. NEW ACCOUNTING POLICY

#### *Other Assets*

Effective April 1, 2004, the Fund adopted the new Canadian accounting guideline AcG-13, Hedging Relationships. EIC-128, Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments, requires all financial derivative instruments to be recorded on the balance sheet as either an asset or liability measured at fair value, with changes in fair value recognised in income unless the arrangement can meet all of the requirements of AcG-13. Other assets represents the estimated fair value of various derivative financial instruments which do not qualify for hedge accounting as outlined in AcG-13. The corresponding gain of \$466 has been recorded in other income for the three months ended June 30, 2004 (see Note 8).

### 3. SEASONALITY OF OPERATIONS

The Fund's operations are seasonal. Gas consumption by customers is typically highest in the fall and winter quarters, October through March and lowest in the spring and summer quarters, April through September. Electricity consumption is typically highest in the winter and summer quarters, January through March and July through September. Electricity consumption is lowest in the fall and spring quarters, October through December and April through June.

### 4. RESTRICTED CASH/CUSTOMER REBATES PAYABLE

Restricted cash represents rebate monies received from Local Distribution Companies (LDCs) as provided by the Independent Market Operator (IMO). OESC is obligated to disperse the monies to eligible end-use customers in accordance with the Market Power Mitigation Agreement as part of OESC's Retailer License Conditions.

### 5. PREFERENCE SHARES OF OESC

#### *Authorised*

Unlimited Class A preference shares, non-voting, exchangeable into trust units in accordance with the OESC shareholders' agreement, with no priority on dissolution.

Unlimited Class B preference shares, non-voting, exchangeable into trust units in accordance with the OESC shareholders' agreement, with no priority on dissolution. The Class B preference shares were redeemable at the option of OESC and retractable at the option of the holder, at a price of \$2.50 per Class B preference share together with all accrued and unpaid dividends subject to consent of the holder or OESC, respectively. Pursuant to the terms of the OESC shareholders' agreement, all shareholder exchange rights relating to Class B preference shares must have been exercised by January 1, 2004.

Pursuant to the "Declaration of Trust" which governs the Fund, the holders of Class A and Class B preference shares are entitled to vote in all votes of Unitholders as if they were the holders of the number of units which they would receive if they exercised their shareholder exchange rights.

Issued and Outstanding	2004		2003	
	Shares	\$	Shares	\$
<b>Class A Preference Shares</b>				
Balance, beginning of period	11,631,178	29,078	11,827,478	29,569
Cancelled/exchanged into units	(196,300)	(491)	(140,038)	(350)
Balance, end of period	<u>11,434,878</u>	<u>28,587</u>	<u>11,687,440</u>	<u>29,219</u>
<b>Class B Preference Shares</b>				
Balance, beginning of period	–	–	1,652,128	4,130
Cancelled/exchanged into units	–	–	(93,744)	(234)
Balance, end of period	<u>–</u>	<u>–</u>	<u>1,558,384</u>	<u>3,896</u>
Combined balance, end of period	<u>11,434,878</u>	<u>28,587</u>	<u>13,245,824</u>	<u>33,115</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – thousands of dollars except where indicated and per unit amount)

### 6. TRUST UNITS

An unlimited number of units may be issued. Each unit is transferable, voting and represents an equal undivided beneficial interest in any distributions from the Fund whether of net income, net realised capital gains or other amounts, and in the net assets of the Fund in the event of termination or winding-up of the Fund.

Issued and Outstanding	2004		2003	
	Units	\$	Units	\$
Balance, beginning of period	91,093,142	177,323	86,038,534	208,078
Options exercised	2,013,324	8,169	1,813,322	7,735
Exchanged from Class A preference shares	196,300	491	140,038	350
Exchanged from Class B preference shares	-	-	93,744	234
Additional units from exchange of Class B preference shares	-	-	4,804	95
Net income	-	4,141	-	769
Distributions	-	(18,960)	-	(16,647)
Class B preference distributions paid	-	-	-	(95)
Class B preference distributions exchangeable into units	-	-	-	1,088
Balance, end of period	<u>93,302,766</u>	<u>171,164</u>	<u>88,090,442</u>	<u>201,607</u>

### 7. UNIT OPTION PLANS

#### (a) Unit option plan

The Fund grants awards under its 2001 unit option plan to directors, officers, full-time employees and service providers (non-employees) of its subsidiaries and affiliates. In accordance with the unit option plan subsequent to the unit split which took effect January 30, 2004, the Fund may grant options to a maximum of 11,300,000 units. As at June 30, 2004 there were 1,188,333 options still available for grant under the plan. Of the options issued, 2,718,336 remain outstanding at quarter end. The exercise price of the unit options equals the closing market price of the Fund's units on the last business day preceding the grant date. The unit options will vest over periods ranging from three to five years from the grant date and expire after five or ten years from the grant date.

A summary of the status of the Fund's unit option plan is outlined below.

	Outstanding Options	Range of Exercise prices	Weighted average exercise price <sup>1</sup>	Weighted average grant date fair value <sup>2</sup>
Balance, beginning of period	4,651,660	\$2.50 – \$15.45	\$5.17	
Granted	80,000	\$16.58 – \$17.48	\$17.14	\$2.67
Exercised	(2,013,324)	\$2.50 – \$8.75	\$2.53	
Balance, end of period	<u>2,718,336</u>	\$2.50 – \$17.48	\$7.48	

<sup>1</sup>The weighted average exercise price is calculated by dividing the exercise price of options granted by the number of options granted.

<sup>2</sup>The weighted average grant date fair value is calculated by dividing the fair value of options granted by the number of options granted.

Range of Exercise Prices	Options Outstanding		Options Exercisable		
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$2.50 – \$3.24	266,664	1.88	\$2.65	253,330	\$2.62
\$4.24 – \$6.09	1,339,340	2.60	\$5.09	49,333	\$5.99
\$7.29 – \$7.58	180,000	2.99	\$7.54	13,333	\$7.29
\$8.75 – \$12.17	837,332	7.66	\$11.77	71,333	\$10.84
\$14.25 – \$17.48	<u>95,000</u>	4.60	\$16.75		
Balance, end of period	<u>2,718,336</u>	4.18	\$7.48	<u>387,329</u>	\$4.72

#### Options Available for Grant

Available for grant	11,300,000
Add: cancelled/forfeited in prior years	881,333
Less: granted in prior years	<u>(10,913,000)</u>
Balance, beginning of period	1,268,333
Less: granted during the period	<u>(80,000)</u>
Balance, end of period	<u>1,188,333</u>

The Fund uses a binomial option pricing model to estimate the fair values. The binomial model was chosen because of the yield associated with the units. Fair values of employee unit options are estimated at grant date. Fair values of non-employee unit options are estimated and revalued each reporting period until a measurement date is achieved. The following weighted average assumptions have been used in the valuations:

Risk free rate	3.4 – 5.6%
Expected volatility	22.80% – 26.18%
Expected life	3 – 5 years
Expected distributions	\$0.30 – \$0.835 per year

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – thousands of dollars except where indicated and per unit amount)

### 7. UNIT OPTION PLANS (cont'd)

#### (b) Unit appreciation rights

The Fund grants awards under its 2004 unit appreciation rights plan to senior officers or service providers of its subsidiaries and affiliates. In accordance with the unit appreciation rights plan, the Fund may grant unit appreciation rights ("UARs") to a maximum of 1,000,000. As at June 30, 2004 there were 965,568 UARs still available for grant under the plan. Except as otherwise provided, the UARs will vest over five years from the grant date and expire no later than ten years from the grant date.

#### UARs Available for Grant

Available for grant	1,000,000
Less: granted during the period	(34,432)
Balance, end of period	<u>965,568</u>

#### (c) Deferred unit grants

The Fund grants awards under its 2004 Director's deferred compensation plan to all independent directors of OESC. In accordance with the deferred compensation plan, the Fund may grant deferred unit grants ("DUGs") to a maximum of 100,000. The DUGs vest the earlier of the date of resignation or three years following the date of issuance and expire ten years following the date of grant. As of June 30, 2004, no DUGs have been granted.

Total amounts credited to contributed surplus in respect of unit based compensation awards and unit appreciation rights amounted to \$435 for the period ended June 30, 2004 (2003 - \$1,627).

Total amounts charged to contributed surplus in respect of awards exercised during the period ended June 30, 2004 amounted to \$3,070 (2003 - \$2,509).

Cash received from options exercised during the period ended June 30, 2004 amounted to \$5,099 (2003 - \$5,226).

### 8. FINANCIAL INSTRUMENTS

#### (a) Fair value

The Company has a variety of gas and electricity supply contracts that are considered derivative financial instruments. The fair value of derivative financial instruments is the estimated amount the Company would pay or receive for these supply contracts at market prices. The value is based on market prices or management's best estimates if there is no organised market and/or if the market is illiquid.

At June 30, 2004, the Company had electricity derivative contracts designated as hedges of the Company's electricity operations with the following terms:

Notional volumes (peak and flat)	5 - 75 MW/h
Maturity dates	July 31, 2004 - December 31, 2008
Fixed price per MW (in dollars)	\$39.25 - \$73.78
Fair value	\$57,295 gain
Notional value	\$575,334

At June 30, 2004, the Company had fixed-for-floating gas swaps which have been marked to market with the following terms:

Notional volume	1,000 GJ/day
Maturity date	November 30, 2005
Fixed price per GJ (in dollars)	\$5.23
Fair value	\$822 gain
Notional value	\$2,709

The gain of \$822 has been recorded in other assets with its offsetting value being recorded in other income.

At June 30, 2004, the Company had other gas financial instruments which have been marked to market with the following terms:

Notional volume	125 - 400 GJ/day
Maturity dates	July 31, 2004 - October 31, 2008
Fixed price per GJ (in dollars)	\$5.48 - \$5.55
Fair value	\$504 loss

The loss of \$504 has been recorded in other assets with its offsetting value being recorded in other income.

At June 30, 2004, the Company had other gas financial instruments which have been marked to market with the following terms:

Notional volume	4,000 - 20,500 MmBTU/month
Maturity dates	June 30, 2005 - June 30, 2009
Fixed price per MmBTU (in dollars)	\$7.34 - \$8.00 (US\$5.50 - US\$6.00)
Fair value	\$148 gain (US\$115)

The gain of \$148 has been recorded in other assets with its offsetting value being recorded in other income.

The Company's physical gas supply contracts are not considered derivative financial instruments and a fair value has therefore not been assessed.

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, management incentive program payable and unit distribution payable approximates their fair value due to their short term liquidity.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited — thousands of dollars except where indicated and per unit amount)

### 8. FINANCIAL INSTRUMENTS (cont'd)

#### (b) Interest rate risk

OESC entered into a \$10,000 operating facility agreement for a term of 364 days, in order to finance general requirements. The facility expires on March 5, 2005. The operating line of credit bears interest at bank prime plus 0.5% and letters of credit bear interest at 1.5%. Total letters of credit outstanding as at June 30, 2004 amounted to \$7,051. The letters of credit are primarily to suppliers in support of future commodity purchases. No amounts have been drawn against the operating facility agreement at June 30, 2004 or 2003.

### 9. NET INCOME (LOSS) PER UNIT

	2004	2003
<b>Basic income (loss) per unit</b>		
Net income	\$ 4,141	\$ 769
Class B preference distributions exchangeable into units	—	(1,088)
Net income (loss) available to Unitholders	\$ 4,141	\$ (319)
Average number of units outstanding	92,365	87,066
Basic income (loss) per unit	\$ 0.04	\$ (0.01)
<b>Diluted income (loss) per unit<sup>1</sup></b>		
Net income	\$ 4,141	\$ 769
Management incentive program (net of tax - 36%; 2003 - 34%)	1,510	1,377
Diluted income available to Unitholders	\$ 5,651	\$ 2,146
Average number of units outstanding	92,365	87,066
Dilutive effect of:		
Class A preference shares	11,629	11,826
Class B preference shares	—	1,651
Class B preference shares additional unit entitlement	—	50
Unit options	2,071	3,823
Unit appreciation rights	34	—
Units outstanding on a diluted basis	106,099	\$ 104,416
Diluted income (loss) per unit	\$ 0.04	\$ (0.01)

<sup>1</sup> Conversion of convertible securities is anti-dilutive to income (loss) per unit for the period ended June 30, 2004 and 2003.

### 10. REPORTABLE BUSINESS SEGMENTS

The Fund operates in two reportable business segments, which are the reselling of gas and electricity to end-use customers. The Fund operates in two geographic areas, Canada and the United States. The results from operations in the United States are insignificant for the three months ended June 30, 2004 and 2003, and therefore have not been separately disclosed.

The Fund evaluates segment performance based on gross margin.

The Fund's business segments are strategic business units that offer a distinct product. Each segment has senior level executives responsible for the performance of the segment.

The following table presents the Fund's results from continuing operations by reportable segment:

#### THREE MONTHS ENDED JUNE 30, 2004

	Gas	Electricity	Corporate	Consolidated
Sales from external customers and third parties	\$ 125,931	\$ 60,142	\$ —	\$ 186,073
Gross margin	\$ 23,035	\$ 8,723	\$ —	\$ 31,758
Expenses	—	—	(32,894)	(32,894)
Other income	466	—	116	582
Recovery of income tax	—	—	4,695	4,695
Net income (loss)	\$ 23,501	\$ 8,723	\$ (28,083)	\$ 4,141
Additions to capital assets	\$ 902	\$ 54	\$ 643	\$ 1,599
Total goodwill	\$ 94,576	\$ —	\$ —	\$ 94,576
Total assets	\$ 205,875	\$ 18,315	\$ 49,148	\$ 273,338

#### THREE MONTHS ENDED JUNE 30, 2003

	Gas	Electricity	Corporate	Consolidated
Sales from external customers and third parties	\$ 91,388	\$ 40,912	\$ —	\$ 132,300
Gross margin	\$ 21,386	\$ 5,009	\$ —	\$ 26,395
Expenses	—	—	(30,371)	(30,371)
Other income	—	—	150	150
Recovery of income tax	—	—	4,595	4,595
Net income (loss)	\$ 21,386	\$ 5,009	\$ (25,626)	\$ 769
Additions to capital assets	\$ —	\$ 125	\$ 729	\$ 854
Total goodwill	\$ 94,576	\$ —	\$ —	\$ 94,576
Total assets	\$ 255,288	\$ 16,138	\$ 40,030	\$ 311,456

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – thousands of dollars except where indicated and per unit amount)

### 11. GUARANTEES

#### (a) Officers and Directors

Corporate indemnities have been provided by the Fund to all directors and certain officers of its subsidiaries and affiliates for various items including, but not limited to, all costs to settle suits or actions due to their association with the Fund and its subsidiaries and/or affiliates, subject to certain restrictions. The Fund has purchased directors' and officers' liability insurance to mitigate the cost of any potential future suits or actions. Each indemnity, subject to certain exceptions, apply for so long as the indemnified person is a director or officer of one of the Fund's subsidiaries and/or affiliates. The maximum amount of any potential future payment cannot be reasonably estimated.

#### (b) Operations

In the normal course of business, the Fund and/or the Fund's subsidiaries and affiliates have entered into agreements that include guarantees in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with consultants, leasing agreements and service agreements. These guarantees may require the Fund and/or its subsidiaries and affiliates to compensate counterparties for losses incurred by the counterparties as a result of breaches in representation and regulations or as a result of litigation claims or statutory sanctions that may be suffered by the counterparty as a consequence of the transaction. The maximum amount of any liability cannot be reasonably estimated under these guarantees.

The nature of these guarantees prevents the Fund from making a reasonable estimate of the maximum exposure due to the difficulties in assessing the amount of liability which stems from the unpredictability of future events and the unlimited coverage offered to counterparties. Historically, the Fund has not made any payments under such or similar indemnification agreements and therefore no amount has been accrued in the balance sheet with respect to these agreements.

### 12. COMMITMENTS

#### (a) Commitments for premises and equipment under lease obligation for the next five fiscal years are as follows:

2005	\$	1,950
2006		1,886
2007		1,738
2008		1,549
2009 and beyond		4,326
	\$	<u>11,449</u>

#### (b) The Company is committed under a marketing agreement for the next three fiscal years with the following minimum payments:

2005	\$	2,041
2006		2,041
2007		2,041
	\$	<u>6,123</u>

#### (c) The Company is committed under long term gas and electricity supply contracts with various suppliers for the next five fiscal years as follows:

2005	\$	467,327
2006		551,840
2007		418,031
2008		299,256
2009 and beyond		157,636
	\$	<u>1,894,090</u>

The Company is also committed under long-term contracts with customers to supply gas and electricity. Both the purchase and sales contracts have various expiry dates and renewal options.

Gas and electricity is delivered to the end-use customers by LDCs under contract with the Company. The Company has entered into letter agreements for the assignment of LDC proceeds to which it would otherwise be entitled in favour of Coral Energy Canada Inc.

## OFFICERS AND DIRECTORS

### REBECCA MACDONALD

*Chair and Chief Executive Officer*

### BRENNAN R. MULCAHY

*President*

### JOHN PANNETON

*President, Goodman Private Wealth Management*

### HUGH D. SEGAL

*President, Institute for Research on Public Policy*

### BRIAN R.D. SMITH

*Federal Chief Treaty Negotiator and Energy Consultant*

### THE HON. MICHAEL J.L. KIRBY

*Member of Senate of Canada and Corporate Director*

### ALEK KRSTAJIC

*Chief Marketing Officer, Consumer Markets Bell Canada and Corporate Director*

### JOHN A. BRUSSA

*Partner, Burnet, Duckworth & Palmer LLP*

### Officers (non Board)

#### DEBBIE S. WERNET

*President – U.S. Energy Savings Corp*

#### KEN HARTWICK, C.A.

*Chief Financial Officer*

#### PAUL DEVRIES

*Chief Operating Officer*

### SHARES LISTED

Toronto Stock Exchange, Trading Symbol: SIF.UN

### TRANSFER AGENT AND REGISTRAR

Computershare Trust Company of Canada

100 University Avenue

Toronto, Ontario M5J 2Y1

### FOR FINANCIAL INFORMATION CONTACT

Ken Hartwick, C.A.

*Chief Financial Officer*

*Telephone: 905-795-3557*

### FOR FURTHER INFORMATION CONTACT

Rebecca MacDonald

*Chair & Chief Executive Officer*

*Telephone: 905-367-2872*

### HEAD OFFICE

Energy Savings Income Fund

130 King Street West, Suite 2830

Toronto, Ontario M5X 1E1

Telephone: 416-367-2998 Fax: 416-367-4749

[www.esif.ca](http://www.esif.ca)