

ONTARIO ELECTRICITY FINANCIAL CORPORATION

Bulletin

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2004 OEFC Annual Report Highlights

www.oefc.on.ca

Highlights 2003-04

OEFC achieved the following results in relation to its objectives as outlined in the 2004 Annual Report:

- Met long-term borrowing requirements of \$5,490 million, including the refinancing of maturing debt, in a cost effective manner.
- Eliminated all foreign exchange exposure on outstanding debt through prudent risk management.
- Managed the Electricity Consumer Price Protection Fund (ECPPE) created under the *Electricity Pricing, Conservation and Supply Act, 2002*.
- Implemented contracts for 249 megawatts of temporary generation capacity, providing additional back-up resources for the summer and fall of 2003.
- Reached agreements for the revision of seven additional Power Purchase Agreements (PPAs) with Non Utility Generators (NUGs), bringing the total revised PPAs to twenty-three.
- Continued to develop the necessary infrastructure to manage the PPAs and related exposures in a competitive market in a cost-effective and prudent manner.
- Negotiated agreements with three NUGs to provide additional NUG capacity.
- Managed the obligation under the Ontario Nuclear Funds Agreement (ONFA) between the Province, Ontario Power Generation (OPG) and certain OPG subsidiaries. OEFC funded \$1.2 billion of the nuclear funding liability of \$3 billion, which OEFC assumed as a legacy liability of the former Ontario Hydro.

Overview of Financial Results

For the year ended March 31, 2004, revenues totalled \$3,022 million, while expenses totalled \$3,389 million, resulting in a deficiency of revenue over expense of \$367 million, compared to the prior year's deficiency of revenue over expense of \$98 million.

On April 1, 1999, unfunded liability was \$19.4 billion. As of March 31, 2004, OEFC's unfunded liability was \$20.6 billion.

Please see the 2004 OEFC Annual Report for more information.

2003-04 Borrowing Program

In 2003-04, the Province completed OEFC's long-term public borrowing requirements of \$5.5 billion. This amount includes the refinancing of \$2.3 billion of long-term debt maturities, \$1.2 billion to refinance maturities in transactions to fix interest rates on short-term debt, \$1.2 billion to fund the nuclear funding liability under ONFA and \$1.0 billion to meet OEFC's total obligation to the ECPPE, offset by \$0.7 billion in principal repayment of notes receivable by Hydro One.

Risk Management

OEFC's foreign exchange and floating rate exposures have remained within policy limits in 2003-04.

- Floating interest rate exposure was eight percent at March 31, 2004, within the OEFC's limit of 20 percent.
- Foreign exchange exposure was zero percent at March 31, 2004, within the OEFC's limit of five percent.

An appreciation of the Canadian dollar in 2003 provided OEFC with an opportunity to reduce the policy limit of its unhedged foreign exchange exposure to five per cent of outstanding debt from 20 per cent. Through the use of derivative instruments, OEFC reduced its U.S. dollar exposure by U.S.\$1.1 billion, thereby eliminating all of OEFC's remaining foreign exchange exposure. This will eliminate the sensitivity of OEFC's annual financing charges to movements in the Canadian dollar/U.S. dollar exchange rate.

Debt Repayment Plan

OEFC's mandate is to service and retire the debt and other liabilities of the former Ontario Hydro from within the electricity sector. As the legal continuation of the former Ontario Hydro, OEFC services and retires the debt and other liabilities through revenues and cashflows from the following sources:

- Outstanding notes receivable from the Province, Ontario Power Generation and Independent Electricity Market Operator;
- Payments-in-lieu (PILs) of corporate income, capital and property taxes, made by OPG, Hydro One and municipal electric utilities;
- Debt Retirement Charge paid by electricity consumers; and
- Electricity sector dedicated income: the Province's combined net incomes from OPG and Hydro One in excess of the Province's interest cost of its investment in these electricity subsidiaries.

Management of Power Purchase Agreements

- In the late 1980s and early 1990s, the former Ontario Hydro entered into approximately 90 long-term PPAs with NUGs. These PPAs, which expire on various dates until 2048, represent approximately 1,700 megawatts of generating capacity.
- During 2003-04, OEFC negotiated revisions to seven additional NUG contracts to facilitate their integration into the competitive electricity market and reduce above-market costs. This brings the total revised NUG contracts to twenty-three. OEFC also completed three incremental power agreements with existing NUGs, providing 46 megawatts of additional NUG capacity during 2003.
- In addition, OEFC completed five paid-to-produce agreements. These arrangements increased OEFC's ability to manage NUG costs and exposures effectively and maximize NUG output during periods of tight electricity supply.

Outlook for 2004-05

Implications of Electricity Sector Reforms for OEFC

The government introduced legislation on June 15, 2004 to implement its vision for reforming the electricity sector, and if the legislation is passed in the fall of 2004, the new market structure is expected to be in place early in 2005.

OEFC will continue to support the implementation of the government's electricity sector initiatives, where those initiatives touch on OEFC's mandate and monitor the financial performance of the successor companies and other policy developments to determine the impact on OEFC. If legislation to implement reforms to the electricity sector is passed, it would have a significant financial impact on OEFC.

For example, under the new market structure, the above-market portion of the existing power purchase agreements with the non-utility generators would be passed on to the electricity consumer over the life of the contracts. OEFC anticipates that this would eliminate the liability for above-market costs under its power purchase agreements, expected to be about \$3.9 billion at that time.

Other Corporate Objectives

- Provide borrowing, risk management, cash management, banking, accounting and forecasting services as required in managing and retiring the outstanding debt and derivative contracts of the former Ontario Hydro.
- Proceed with payments to reduce the commitment-in-lieu for nuclear liabilities associated with the financial restructuring of the former Ontario Hydro.
- Develop and implement the necessary infrastructure to manage, in a cost-effective and prudent manner, the NUG contracts and related exposures and their integration into the power market.
- Negotiate revisions to the NUG contracts to ensure that the contracts are consistent with the electricity sector as it develops.
- Manage the ECPPF to ensure accuracy of claims under the interim pricing structure, which is expected to be in place until 2005. This pricing structure, which charges consumers 4.7 cents per kilowatt-hour for the first 750 kilowatt-hours of consumption per month and 5.5 cents per kilowatt-hour for additional volumes, better reflects the true cost of power and is expected to result in no net cost for the ECPPF in 2004-05.

Additional Information

Ontario Electricity Financial Corporation (OEFC), an agency of the Province of Ontario, is a statutory, non-share capital corporation and the legal continuation of Ontario Hydro.

A full set of 2003-04 OEFC financial statements can be found in the 2004 OEFC Annual Report at www.oefc.on.ca

Contact (416) 325-8000 or email investor@oefc.on.ca to request a hard copy of the report.