

This short form prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities regulatory authority has expressed an opinion about these securities and it is an offence to claim otherwise.

A copy of this preliminary short form prospectus has been filed with the securities regulatory authorities in each of the provinces of Canada but has not yet become final for the purpose of the sale of securities. Information contained in this preliminary short form prospectus may not be complete and may have to be amended. The securities may not be sold until a receipt for the short form prospectus is obtained from the securities regulatory authorities.

Information has been incorporated by reference in this prospectus from documents filed with securities commissions or similar authorities in Canada (the permanent information record in Québec). Copies of the documents incorporated herein by reference may be obtained on request without charge from the President, Algonquin Power Management Inc., 2845 Bristol Circle, Oakville, Ontario, L6H 7H7, telephone (905) 465-4500 and fax (905) 465-4540. For the purpose of the Province of Québec, this simplified prospectus contains information to be completed by consulting the permanent information record. A copy of the permanent information record may be obtained from the President, Algonquin Power Management Inc. at the above-mentioned address and telephone number.

These securities have not been and will not be registered under the United States Securities Act of 1933, as amended, and, subject to certain exceptions, may not be offered or sold within the United States of America, or to, or for the account or benefit of, U.S. persons. See "Plan of Distribution".

PRELIMINARY SHORT FORM PROSPECTUS

New Issue

September 30, 2002



ALGONQUIN POWER INCOME FUND

\$85,140,000

8,600,000 Trust Units

This prospectus qualifies the distribution of up to 10,120,000 trust units ("Trust Units") to be issued and sold by Algonquin Power Income Fund pursuant to this offering. The Trust Units are being sold as to 8,600,000 Trust Units on a firm underwritten basis and as to 1,520,000 Trust Units on a best efforts agency basis. Each Trust Unit represents an equal undivided beneficial interest in the Fund. The Fund has 57,937,612 Trust Units issued and outstanding. The Fund is administered by Algonquin Power Management Inc. (the "Manager"). The net proceeds of this offering will be used to acquire interests in additional facilities, repay debt and for working capital.

The Fund currently holds an interest, directly or indirectly, in 57 hydroelectric, bio-mass, natural gas/wood waste and natural gas powered generating facilities and three water distribution and wastewater treatment facilities located in Canada and the United States. The Manager manages such facilities.

The Fund will make monthly, as opposed to quarterly, cash distributions to holders of Trust Units of record on the last day of each calendar month, commencing with the month ending October 31, 2002. Such monthly distributions are paid by the 45th day following each record date. The next distribution following closing of this offering is expected to be paid on November 15, 2002 to unitholders of record on September 30, 2002, which distribution will be a quarterly distribution. Subsequent distributions will be monthly distributions.

The terms of this offering were established through negotiation between the Manager on behalf of the Fund and BMO Nesbitt Burns Inc., National Bank Financial Inc., CIBC World Markets Inc., TD Securities Inc., RBC Dominion Securities Inc., Scotia Capital Inc. and Raymond James Ltd. (collectively, the "Underwriters"). The Manager is wholly-owned by the shareholders of Algonquin Power Corporation Inc. **Two of the Underwriters, National Bank Financial Inc. and TD Securities Inc., are subsidiaries of Canadian chartered banks which provided a line of credit (the "Line of Credit") to the Fund. Consequently, the Fund may be considered a connected issuer of these Underwriters under applicable Canadian securities legislation. See "Plan of Distribution".** The Trust Units will not be obligations of or interests in any person other than the Fund. **The Fund is not a trust company and is not registered under applicable legislation governing trust companies, as it does not carry on or intend to carry on the business of a trust company. The Trust Units are not "deposits" within the meaning of the Canada Deposit Insurance Corporation Act (Canada) and are not insured under the provisions of that Act or any other legislation.** The Underwriters may effect transactions which stabilize or maintain the market price for the Trust Units at levels other than those which otherwise might prevail in the open market. See "Plan of Distribution".

Subject to certain assumptions, limitations and restrictions described in the section entitled "Canadian Federal Income Tax Considerations" in the Annual Information Form, in the opinion of Blake, Cassels & Graydon LLP, as of the date of this prospectus, the Trust Units are qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans under the *Income Tax Act* (Canada), are not foreign property within the meaning of the *Income Tax Act* (Canada) and are not precluded as investments under certain other statutes. See "Eligibility for Investment" and "Canadian Federal Income Tax Considerations" in the Annual Information Form.

Price: \$9.90 per Trust Unit

	Price to the Public ⁽¹⁾	Underwriters' Fee	Net Proceeds to the Fund ⁽²⁾
Per Trust Unit	\$9.90	\$0.495	\$9.405
Total Offering	\$9.90	\$4,257,000	\$80,883,000

- Notes:
- (1) The price of the additional Trust Units was established through negotiation between the Manager on behalf of the Fund and the Underwriters.
 - (2) Before deduction of the expenses of this offering, estimated at \$300,000, which, together with the Underwriters' fee, will be paid by the Fund out of the proceeds of this offering.
 - (3) In addition, up to 1,520,000 Trust Units may be sold by the Underwriters on a best efforts agency basis resulting in Underwriters' fees of \$752,400 and net proceeds of \$14,295,600 and aggregate Underwriters' fees of \$5,009,400 and aggregate net proceeds of \$95,178,600, respectively.

The Trust Units are listed for trading on The Toronto Stock Exchange under the trading symbol of APF.UN. The closing price of the Trust Units on The Toronto Stock Exchange on September 27, 2002 was \$9.91.

The Underwriters, as principals, conditionally offer the Trust Units, subject to prior sale, if, as and when issued and sold by the Fund and accepted by the Underwriters in accordance with the conditions contained in the Underwriting Agreement and subject to the approval of certain legal matters on behalf of the Fund by Blake, Cassels & Graydon LLP and on behalf of the Underwriters by Cassels Brock & Blackwell LLP.

Subscriptions will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. The closing of this offering is expected to occur on or about October 16, 2002 or such later date as the Manager, the Fund and the Underwriters may agree, but in any event not later than November 18, 2002. Certificates for Trust Units will be available for delivery at closing.

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SUMMARY

The following summary is qualified by and should be read in conjunction with the more detailed information appearing elsewhere in this prospectus.

Algonquin Power Income Fund

The Fund: The Fund is an unincorporated open-ended trust established under the laws of Ontario. The facilities owned by the Fund have been consolidated into four operating divisions reflecting the common characteristics of the asset classes. The *Hydroelectric Division* holds direct and indirect equity interests in 47 hydroelectric generating facilities located in Ontario (5), Quebec (12), Newfoundland (1), Alberta (1), New York State (12), New Hampshire (13), New Jersey (1) and Vermont (2) representing aggregate installed generating capacity of approximately 140MW; the *Cogeneration Division* is comprised of two natural gas fired generating stations representing approximately 57MW of installed capacity located in California and New Jersey and minority term investments in three natural gas fired generating facilities with combined installed capacity of approximately 290MW located across Ontario; and the *Alternative Fuels Division* is comprised of one 10MW energy-from-waste facility located in Ontario, one 1.6MW landfill gas powered generating station located in Illinois and partnership, share and debt interests in three bio-mass fired generating facilities with combined installed capacity of approximately 70MW located in Alberta, Quebec and Nova Scotia. In addition to electricity generating assets, the *Infrastructure Division* of the Fund owns three water distribution and wastewater handling facilities located in Arizona. Reference is made to the section entitled “The Developments” in the Annual Information Form and the sections entitled “Algonquin Power Income Fund — Recent Developments” and “Summary of Additional Facility” hereunder.

The Offering

Issuer: Algonquin Power Income Fund.
Offering: Up to 10,120,000 Trust Units.
Amount: Up to \$100,188,000.
Price: \$9.90 per Trust Unit.
Use of Proceeds: Net proceeds to the Fund from the sale of additional Trust Units, assuming the sale of all Trust Units available on a best efforts agency basis, are estimated to be approximately \$94,878,600, after deducting the fees payable to the Underwriters and the estimated expenses of the offering.

Funds Available

Net Proceeds	\$94,878,600
Use of Funds Available	
Acquisitions, repayment of debt and/or working capital	\$94,878,600
Total Use of Funds	\$94,878,600

See “Use of Proceeds”.

Trust Units: Each Trust Unit represents an equal undivided beneficial interest in the assets of the Fund. Each Trust Unit is transferable, entitles the holder thereof to participate equally in distributions of the Fund and to one vote. Trust Units are not subject to future calls or assessments. The Fund currently has 57,937,612 Trust Units issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents of the Fund, filed with the provincial securities commissions or similar authorities in each of the provinces of Canada, are specifically incorporated by reference and form part of this short form prospectus:

- (a) annual information form (the “Annual Information Form”) dated May 17, 2002;
- (b) material change report dated and filed January 25, 2002 in respect of the Fund, KMS Power Income Fund (“KMS”) and others entering into a support agreement pursuant to which a Fund entity agreed to make, and KMS agreed to support, a take-over bid for all of the outstanding trust units and convertible debentures of KMS;
- (c) material change report dated March 20, 2002 and filed March 22, 2002 in respect of the results of the take-over bid by Algonquin Power Trust (the “Algonquin Trust”) for KMS and confirming that the Algonquin Trust had taken-up and paid for all trust units and convertible debentures deposited to the bid;
- (d) material change report dated May 2, 2002 and filed May 3, 2002 in respect of the acquisition by an indirect subsidiary of the Fund of a natural gas fired generating station located in Sanger, California;
- (e) comparative consolidated financial statements of the Fund as at and for the year ended December 31, 2001 together with the prior period financial statements and the auditors’ report thereon;
- (f) management’s discussion and analysis of financial condition and results of operations of the Fund as at and for the year ended December 31, 2001;
- (g) unaudited comparative consolidated financial statements of the Fund contained in the second quarter report to Unitholders of the Fund for the three months and six months ended June 30, 2002;
- (h) management’s discussion and analysis of financial condition and results of operations of the Fund as at and for the three months and six months ended June 30, 2002; and
- (i) management information circular dated April 8, 2002 prepared in connection with the Fund’s annual and special meeting of Unitholders held on May 23, 2002.

All annual information forms, material change reports (excluding confidential material change reports), comparative interim financial statements, comparative financial statements and information circulars which are filed by the Fund with a securities commission or similar authority in Canada after the date of this short form prospectus and prior to the termination of the offering shall be deemed to be incorporated by reference into this short form prospectus.

The following documents of KMS, filed with the provincial securities commissions or similar authorities in each of the provinces of Canada, are specifically incorporated by reference and form part of this short form prospectus:

- (a) comparative consolidated financial statements of KMS as at and for the year ended December 31, 1999 together with the prior period financial statements and the auditors’ report thereon;
- (b) comparative consolidated financial statements of KMS as at and for the year ended December 31, 2000 together with the prior period financial statements and the auditors’ report thereon;
- (c) comparative consolidated financial statements of KMS as at and for the year ended December 31, 2001 together with the prior period financial statements and the auditors’ report thereon;
- (d) unaudited comparative consolidated financial statements of KMS contained in the first quarter report to KMS unitholders for the three months ended March 31, 2002; and
- (e) unaudited comparative consolidated financial statements of KMS for the six months ended June 30, 2002.

Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded, for the purposes of this short form prospectus, to the extent that a

statement contained herein or in a subsequently filed document that is also or is deemed to be incorporated by reference herein modifies or replaces such statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document that it modifies or supersedes. The making of a modifying or superseding statement shall not be deemed an admission for any purposes that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute part of this short form prospectus.

Information has been incorporated by reference in this prospectus from documents filed with securities commissions or similar authorities in Canada (the permanent information record in Québec). Copies of the documents incorporated herein by reference may be obtained on request without charge from the President, Algonquin Power Management Inc., 2845 Bristol Circle, Oakville, Ontario, L6H 7H7, telephone (905) 465-4500 and fax (905) 465-4540. For the purpose of the Province of Québec, this simplified prospectus contains information to be completed by consulting the permanent information record. A copy of the permanent information record may be obtained from the President, Algonquin Power Management Inc. at the above-mentioned address and telephone number.

ALGONQUIN POWER INCOME FUND

General

Algonquin Power Income Fund is an unincorporated open-ended trust established under the laws of Ontario. The Fund was created to acquire an interest in generating facilities and other renewable resource based facilities located in Canada and the United States and to hold such interests for the purposes of earning income therefrom over the useful life of the underlying facilities. The facilities owned by the Fund have been consolidated into four operating divisions reflecting the common characteristics of the asset classes. The *Hydroelectric Division* holds direct and indirect equity interests in 47 hydroelectric generating facilities located in Ontario (5), Quebec (12), Newfoundland (1), Alberta (1), New York State (12), New Hampshire (13), New Jersey (1) and Vermont (2) representing aggregate installed generating capacity of approximately 140MW; the *Cogeneration Division* is comprised of two natural gas fired generating stations representing approximately 57MW of installed capacity located in California and New Jersey and minority term investments in three natural gas fired generating facilities with combined installed capacity of approximately 290MW located across Ontario; and the *Alternative Fuels Division* is comprised of one 10MW energy-from-waste facility located in Ontario, one 1.6MW landfill gas powered generating station located in Illinois and partnership, share and debt interests in three bio-mass fired generating facilities with combined installed capacity of approximately 70MW located in Alberta, Quebec and Nova Scotia. In addition to electricity generating assets, the *Infrastructure Division* of the Fund now owns three water distribution and wastewater handling facilities located in Arizona.

The Fund has four principal direct and indirect subsidiaries — Algonquin Holdco Inc., a wholly-owned subsidiary of the Fund, Algonquin Canada, a wholly-owned subsidiary of Algonquin Holdco Inc., Algonquin America, a wholly-owned subsidiary of Algonquin Canada and Algonquin Water, a wholly-owned subsidiary of Algonquin Canada. Interests in certain of the facilities in Canada are directly or indirectly owned by Algonquin Canada. Interests in certain of the facilities in the United States are directly or indirectly owned by Algonquin America and Algonquin Water. In many cases, interests in the facilities are held by partnerships or corporations which are in turn owned by Algonquin Canada, Algonquin America or Algonquin Water. See the Annual Information Form — “Structure of the Fund” and “Share and Loan Capital”.

In addition to owning the shares of Algonquin Holdco Inc., the Fund is the sole beneficiary of the Algonquin Trust, an unincorporated open-ended trust established under the laws of Ontario. The Algonquin Trust has been established to own certain generating assets of the Fund and other related investments and to operate and lease such assets for the purposes of generating operating revenues for the Fund.

An unlimited number of Trust Units may be issued pursuant to the Declaration of Trust. Each Trust Unit is transferable and represents an equal undivided beneficial interest in any distribution from the Fund, whether of net income, net realized capital gains or other amounts, and in any net assets of the Fund in the event of the

termination or winding-up of the Fund. All Trust Units will rank among themselves equally and rateably without discrimination, preference or priority. Trust Units are not subject to future calls or assessments, except that future offerings of Trust Units may be issuable for consideration payable in instalments, in which case the Fund may take security over any such Trust Units, and each Trust Unit entitles the holder thereof to one vote for each whole Trust Unit held at all meetings of Unitholders. Except as set out in the Annual Information Form — “Development of the Business — Creation of the Fund and Declaration of Trust — Redemption Right”, the Trust Units have no conversion, retraction, redemption or pre-emptive rights. Additional Trust Units may be issued in the future.

The rights and provisions of the Trust Units can only be amended by a resolution at a duly held meeting of Unitholders where two-thirds of the Units represented vote to amend such rights. The Trustees may, without the approval of Unitholders, authorize certain amendments to the Declaration of Trust, including amendments:

- (a) for the purpose of ensuring continuing compliance with the applicable laws, regulations, requirements or policies of any governmental authority having jurisdiction over the Trustees or the Fund;
- (b) which, in the opinion of the Trustees, provide additional protection for the Unitholders;
- (c) to remove any conflicts or inconsistencies in the Declaration of Trust or to make corrections that are, in the opinion of the Trustees, necessary or desirable and not materially prejudicial to the rights of Unitholders; or
- (d) which, in the opinion of the Trustees, are necessary or desirable as a result of changes in or in the administration or interpretation of taxation laws.

The head office and principal business office of the Fund is located at 2845 Bristol Circle, Oakville, Ontario, L6H 7H7.

Recent Developments

On March 15, 2002, the Algonquin Trust completed the acquisition of approximately 86.7% of the outstanding trust units and approximately 47.3% of the outstanding principal amount of convertible debentures of KMS pursuant to a take-over bid for KMS. The Algonquin Trust paid for the KMS trust units and debentures by delivering an aggregate of 6,099,557 Trust Units of the Fund to KMS unitholders and debentureholders who tendered to the take-over bid. On July 1, 2002, the Algonquin Trust completed the acquisition of the remaining trust units of KMS pursuant to the compulsory acquisition provisions of KMS’ declaration of trust by delivering 713,616 Trust Units of the Fund to the KMS unitholders who did not tender to the take-over bid. As a result of the compulsory acquisition, the Algonquin Trust owns 100% of the outstanding trust units of KMS, in addition to approximately 47.3% of the outstanding principal amount of convertible debentures of KMS that were acquired pursuant to the take-over bid. For information regarding the facilities owned by the Algonquin Trust through its ownership of KMS, reference is made to the section entitled “The Developments” in the Annual Information Form. Since the acquisition of KMS may be considered to be a significant acquisition for securities regulatory purposes, certain financial statements of KMS referred to under the section entitled “Documents Incorporated by Reference” are incorporated herein.

In May 2002, the Fund indirectly acquired a 43.5MW natural gas fired generating station (the “Sanger Facility”) located in Sanger, California. The Sanger Facility is a combined cycle generating station comprised of a 32MW Westinghouse natural gas fired turbine and a 11.5MW General Electric steam turbine and has demonstrated a successful operating history since its commissioning in 1991. The aggregate purchase price of approximately \$80 million (US\$50 million) was satisfied in part by the assumption of approximately \$30 million (US\$19 million) of tax-exempt US\$ denominated bonds and with the balance funded jointly through the use of proceeds of previous Trust Unit offerings of the Fund, financing provided by the Fund’s lending syndicate and the issuance of Trust Units of the Fund to the vendor. For additional information relating to the Sanger Facility, reference is made to the section entitled “The Developments” in the Annual Information Form. Since the acquisition of the Sanger Facility may be considered to be a significant acquisition for securities regulatory purposes, certain financial statements of the vendor, Dynamis, Inc., are included herein. Reference is made to the section entitled “Financial Statements — Dynamis, Inc. Financial Statements”.

In May 2002, the Fund indirectly acquired the Bella Vista Water Company (“Bella Vista”) for a cash purchase price of approximately \$20.5 million. Bella Vista is a water distribution company that serves approximately 6,800 customers in the town of Sierra Vista, Arizona, located approximately 100 km southeast of Tucson, Arizona. See the section entitled “Summary of Additional Facility” below.

Since the acquisition of KMS and the Sanger Facility may be considered to be significant acquisitions for securities regulatory purposes, the Fund has prepared pro forma financial statements giving effect to such acquisitions. Reference is made to the section entitled “Financial Statements — Algonquin Power Income Fund Pro Forma Financial Statements”.

As announced at the most recent annual and special meeting of Unitholders, compensation arrangements with the Manager have been amended to reflect the evolving governance and incentive fee arrangements in the income trust sector, while accommodating unique aspects of the Fund’s business and structure. Effective July 1, 2002, the Trustees have agreed with the Manager as follows: (i) except for incentive fees, the Manager will be paid on a cost reimbursement basis only; (ii) the Manager will be paid incentive fees based on 25% of Distributable Cash per Trust Unit in excess of \$0.92 per annum (there will be no further acquisition based incentive fees paid to the Manager); (iii) Power Systems, which is owned by the same shareholders as the Manager and which operates most of the facilities owned directly or indirectly by the Fund, will be paid on a cost reimbursement basis only; and (iv) no fees were paid to the Manager as compensation for the Manager’s consent to these amendments, however, the Trustees have agreed to extend the term of the Management Agreement for an additional five years, with five years’ notice of termination required, provided that the Management Agreement remains subject to termination if there is a substantial deterioration of the Fund’s business. In addition, the Governance Agreement was amended, effective July 1, 2002, to permit the Manager to appoint two of the three directors of Algonquin Holdco and two trustees of the Algonquin Trust, consistent with its right to appoint two of the three directors of Algonquin Canada. This amendment reflects the evolving corporate structure of the Fund since the date that the Governance Agreement was entered into, when all of the Fund’s investments were held through Algonquin Canada. The Manager has not to date exercised its right to appoint trustees of the Algonquin Trust.

At the annual and special meeting of Unitholders held on May 23, 2002, the Unitholders approved a special resolution authorizing a reorganization (the “Reorganization”) under which Algonquin Canada and Algonquin America will issue special voting shares (the “Special Shares”) to the Manager. The effect of the issuance of the Special Shares and the Governance Agreement will be to confer on the Manager as the holder thereof the right to elect two of the three directors of Algonquin Canada and all of the directors of Algonquin America. Pursuant to the Governance Agreement, both before and after its amendment, two of the three directors of Algonquin Canada were and continue to be nominees of the Manager. In addition, all of the directors of Algonquin America are currently principals of the Manager. The Special Shares do not confer any material economic benefit on the Manager, as they are not entitled to receive dividends or other distributions of the assets of Algonquin Canada or Algonquin America, as the case may be. The Special Shares will only carry the right to vote with respect to the election of directors and will not be transferable by the Manager except to a successor manager of the Fund. The terms and conditions of the Special Shares will include a right of Algonquin Canada and Algonquin America, as applicable, and the Fund will directly receive a right, in the event of the termination or expiry of the Management Agreement, to purchase the Special Shares for their issue price. The Fund intends to complete the Reorganization prior to December 31, 2002.

Summary of Additional Facility

Since the date of the Annual Information Form, the Fund acquired an interest in the following facility:

Bella Vista Facility

Bella Vista is a water utility that provides potable water to over 6,800 customers (approximately 800 commercial light industrial and 6,000 residential customers) in Sierra Vista, Cochise County, Arizona. The utility infrastructure consists of four distinct areas, each acquired at different times by Bella Vista: (i) Bella Vista Water, (ii) Nicksville Water, (iii) Rail Oaks Water and (iv) Welch Water.

All of the potable water supplied by Bella Vista is from groundwater. There are 18 wells supplying the Bella Vista Water infrastructure, five wells supplying Nicksville Water, three wells supplying Rail Oaks Water, and three wells supplying Welch Water. The well production capability for the system as a whole is in the order of 5,800 gallons per minute.

Certificate of Convenience and Necessity

The Bella Vista facility has a Certificate of Convenience and Necessity to provide water services to its customers in perpetuity. The utility is regulated by the Arizona Corporation Commission, which regulates rates that can be charged to customers.

Arizona Department of Environmental Quality

The Bella Vista facility is also regulated and must comply with guidelines established by the Arizona Department of Environmental Quality to meet or exceed certain environmental conditions for water quality.

Acquisition Completion Provisions

After closing, the Fund will attempt to identify investment opportunities to acquire interests in facilities which meet the Acquisition Guidelines. The Fund has not entered into any agreements of purchase and sale regarding the acquisition of any prospective facility interests. After identifying and qualifying potential acquisition candidates, the Manager will present to the Trustees those facility interests which the Manager believes meet the acquisition guidelines set out herein (see “Acquisition Guidelines”).

The Fund will only complete the acquisition of any facility interest (an “Acceptable Acquisition”) if: (i) such investment meets the Acquisition Guidelines; (ii) the Fund completes a satisfactory due diligence review of such facility; and (iii) the Fund obtains a satisfactory title search or evidence of satisfactory title insurance. If the Fund identifies and the Trustees approve the acquisition of any particular facility interest, the Fund may utilize a portion of the net proceeds of this offering to complete the acquisition of such facility interest.

If the net proceeds of this offering are insufficient to complete any acquisitions approved by the Trustees as contemplated herein, the Fund will utilize the proceeds from draws on the Line of Credit to augment such net proceeds in order to complete such acquisitions.

Diversified Growth Strategy

The Fund may, where practical and economic, expand its current operations. The energy assets owned by the Fund have been organized into three operating divisions: Hydroelectric, Cogeneration and Alternative Fuels. In addition, the Fund is continuing its diversification strategy through its investment in water infrastructure utilities by way of its Algonquin Water subsidiary. The Trustees have directed the Manager to continue a diversified acquisition strategy which emphasizes a balanced approach to the continued growth of the Fund’s portfolio of energy and infrastructure related facilities. The Trustees believe that the stability and sustainability of cash flows to Unitholders may be enhanced through the diversification of the current asset portfolio.

The Fund will consider investment opportunities which provide stable cash flows including those from renewable resource facilities; potential investment candidates could include wind and bio-mass powered generating facilities or facilities within a regulated utility. Opportunities providing long term, statistically predictable future cash flows whose risk profile is generally consistent with the existing portfolio of energy and infrastructure assets will be considered. All investment opportunities will continue to be required to meet the Acquisition Guidelines established by the Trustees, which guidelines provide that all acquisitions must be expected to result in an increase in Distributable Cash per Trust Unit.

The management of the Manager has extensive experience and contacts in the independent power industry in Canada and the United States and is expected, but is not obligated, to continue presenting appropriate acquisition opportunities to the Fund. Under the terms of the recently revised management compensation structure implemented between the Manager and the Fund, the Manager will **not** be paid any acquisition or transaction related fees in respect of acquisitions by the Fund. Reference is made to the section entitled “Algonquin Power Income Fund — Recent Developments”.

Acquisition Guidelines

After consultation with and approval by the Trustees of the Fund, who have established certain acquisition guidelines which may change depending on circumstances, the Manager intends to pursue an acquisition strategy which will target energy and/or infrastructure facilities and will employ the following guidelines in the review and evaluation of possible acquisitions:

- (a) each facility, development or group of developments will only be acquired if the Fund believes that the acquisition will provide a forecast internal rate of return that is greater than 200 basis points above the yield of long-term (20 year) Government of Canada bonds over the expected life of the facility after deducting operating costs, general, administrative and management expenses and incorporating the impact of debt financing, but before income taxes;
- (b) each facility, development or group of developments will only be acquired if the Fund believes that the acquisition will likely result in an increase in Distributable Cash per Trust Unit;
- (c) facilities or group of facilities for which no existing debt financing is in place will be preferred;
- (d) facilities where Power Systems will become the operator will be preferred;
- (e) facilities in respect of which long term power purchase agreements with major electrical utilities exist or facilities within a regulated utility will be preferred and in other cases, commodity price forecasts and exchange rate assumptions used in acquisition evaluations will reflect market expectations;
- (f) the acquisition of each facility, or development, will be based on an independent engineering report confirming the condition of each of the facilities and the technical assumptions utilized in the acquisition evaluation;
- (g) for each facility in which an interest with an indefinite term is being acquired, the expected useful life of such facility and associated structures will, with regular maintenance, overhauls and upkeep, be not less than 25 years; and
- (h) the acquisition of each facility, or development, will be reviewed and approved by the Trustees.

All acquisitions must be in accordance with the Declaration of Trust and, in particular, the sole undertaking of the Fund.

SHARE AND LOAN CAPITAL

Trust Unit and Loan Capital of the Fund

The Fund presently has 57,937,612 Trust Units outstanding. Since December 31, 2001, the Fund has issued 6,099,557 Trust Units in connection with the acquisition by the Algonquin Trust of 86.7% of the outstanding trust units and 47.3% of the outstanding principal amount of convertible debentures of KMS pursuant to the Algonquin Trust's takeover bid for KMS; 248,667 Trust Units in connection with the acquisition by Snager Power, L.L.C., an indirect subsidiary of Algonquin Canada, of the Sanger Facility; and 713,616 Trust Units in connection with the compulsory acquisition by the Algonquin Trust of the remaining trust units of KMS. As of September 30, 2002, the Fund has approximately \$66.5 million of indebtedness outstanding under the Line of Credit. In addition, the Fund has used the Line of Credit to post (i) a letter of credit in the approximate amount of U.S.\$19.4 million in respect of bond liabilities assumed in connection with the acquisition of the Sanger Facility, and (ii) a \$1 million letter of credit to the Minister of the Environment (Alberta) pursuant to the Use of Works Agreement in respect of the Dickson Dam Facility. The Fund is in compliance with the terms of the agreements governing the Line of Credit and no waiver of any breach has occurred thereunder. The Fund has granted a security interest over all of its assets to secure the indebtedness under the Line of Credit.

Trust Unit and Loan Capital of Algonquin Power Trust

Since December 31, 2001, the Algonquin Trust issued certain trust units and notes to the Fund, with each trust unit representing an equal undivided beneficial interest in the Algonquin Trust. On March 11, 2002, May 1, 2002 and July 14, 2002, the Algonquin Trust issued trust units and notes to the Fund, for aggregate consideration

of approximately \$67.1 million, \$49.0 million and \$7.3 million, respectively. The Algonquin Trust used the proceeds to subscribe for Trust Units which were used to acquire 86.7% of the outstanding trust units and 47.3% of the outstanding principal amount of the convertible debentures of KMS pursuant to the Algonquin Trust's take-over bid for KMS; to subscribe for Trust Units which, together with cash proceeds, were provided to Sanger Power, L.L.C., in connection with the acquisition of the Sanger Facility; and to subscribe for Trust Units which were used to complete a compulsory acquisition of the remaining trust units of KMS.

In addition to the trust units and notes issued by the Algonquin Trust to the Fund during 2002, the Algonquin Trust has outstanding trust units and notes issued to the Fund, with each trust unit representing an equal undivided beneficial interest in the Algonquin Trust, totalling approximately \$143.1 million.

The Fund is the sole unitholder of the Algonquin Trust and the sole holder of notes issued by the Algonquin Trust.

Loan Capital of Algonquin Canada

Since December 31, 2001, Algonquin Canada issued secured, subordinated notes on May 23, 2002 in the principal amounts of approximately \$19.6 million (the "Canada 2002 Notes"). Algonquin Canada used the proceeds from the issuance of the Canada 2002 Notes to acquire the US Water 2002 Notes issued by Algonquin Water. All such notes are held, directly or indirectly, by the Fund.

Interest on Canada 2002 Notes

The Canada 2002 Notes bear interest at the rate of 7% per annum, payable monthly. The Canada 2002 Notes are due on March 16, 2041.

The Canada 2002 Notes provide that Algonquin Canada may defer payment of interest to the extent that its earnings before interest, taxes, depreciation and amortization are inadequate to pay the interest on such notes. Any interest deferred for a period exceeding 12 months will be capitalized as part of the principal outstanding under such notes, as applicable.

Redemption of Canada 2002 Notes

The principal amount of the Canada 2002 Notes will be retired prior to maturity from available cash after payment of interest on the Canada 1998 Note, interest on the Canada 1999 Note and interest on the Canada 2001 Notes in respective amounts as may be determined by Algonquin Canada's board of directors. In any event, the principal amount of the Canada 2002 Notes remaining outstanding on the due date will be immediately due and payable by Algonquin Canada.

Ranking of Canada 2002 Notes

The Canada 1998 Note, the Canada 1999 Note, the Canada 2001 Notes and the Canada 2002 Notes all rank pari passu with each other. The Canada 1998 Note, the Canada 1999 Note, the Canada 2001 Notes and the Canada 2002 Notes are jointly secured by all of the assets of Algonquin Canada. At the discretion of Algonquin Canada's board of directors, Algonquin Canada has the ability to postpone repayment of any of the Canada 1998 Note, the Canada 1999 Note, the Canada 2001 Notes or the Canada 2002 Notes and subordinate the security related thereto to any indebtedness and related security that may be incurred by Algonquin Canada in the future.

Default on Canada 2002 Notes

The Canada 2002 Notes provide that any of the following will constitute an event of default: (i) default in payment of the principal when due; (ii) default on any senior indebtedness for borrowed money; (iii) certain events of winding-up, liquidation, bankruptcy, insolvency, receivership, general assignment for the benefit of creditors or proceedings with respect to a compromise or arrangement under applicable bankruptcy or insolvency legislation; (iv) the taking of possession by an encumbrancer of all or substantially all of the property of Algonquin Canada; (v) ceasing to carry on in the ordinary course the business of Algonquin Canada; (vi) default in performing any material lease, licence or other agreement whereby any material property or rights

of Algonquin Canada may be forfeited or terminated; (vii) default in the observance or performance of any other covenant or condition of the note and the continuance of such default for a period of 30 days after notice in writing has been given to Algonquin Canada specifying such default and requiring Algonquin Canada to rectify same; and (viii) final judgment(s) for the payment of money aggregating in excess of \$500,000 against Algonquin Canada or any of its property and any one such judgment remains unpaid, unvacated, unbonded or unstayed for a period of 30 days after entry.

Loan Capital of Algonquin America

Since December 31, 2001, Algonquin America issued secured, subordinated notes on May 1, 2002 in the principal amount of approximately \$49.0 million (the "US 2002 Notes"). Algonquin America used the proceeds from the issuance of the US 2002 Notes to fund Sanger Power, L.L.C. and acquire the Sanger Facility. All notes issued by Algonquin America are held, directly or indirectly, by the Fund.

Interest on US 2002 Notes

The US 2002 Notes bear interest at the rate of 7.1% per annum, payable monthly. The US 2002 Notes are due on March 21, 2041.

The interest and principal on the US 2002 Notes are payable in Canadian funds. The US 2002 Notes provide that Algonquin America may defer payment of interest to the extent that its earnings before interest, taxes, depreciation and amortization are inadequate to pay the interest on such notes. Any interest deferred for a period exceeding 12 months will be capitalized as part of the principal outstanding under such notes, as applicable.

Redemption of US 2002 Notes

The principal amount of the US 2002 Notes will be retired prior to maturity from available cash after payment of interest on the US Note, interest on the US 1998 Note, interest on the US 1999 Notes (Nos. 1 and 2), interest on the US 2000 Notes, interest on the US 2001 Notes and interest on the US 2002 Notes in respective amounts as may be determined by Algonquin America's board of directors. In any event, the principal amount of the US 2002 Notes remaining outstanding on the due date will be immediately due and payable by Algonquin America.

Ranking of US 2002 Notes

The US Note, the US 1998 Note, the US 1999 Notes (Nos. 1 and 2), the US 2000 Notes, the US 2001 Notes and the US 2002 Notes all rank pari passu with each other. The US Note, the US 1998 Note, the US 1999 Notes (Nos. 1 and 2), the US 2000 Notes, the US 2001 Notes and the US 2002 Notes are jointly secured by all of the assets of Algonquin America. At the discretion of Algonquin America's board of directors, Algonquin America has the ability to postpone repayment of any of the US Note, the US 1998 Note, the US 1999 Notes (Nos. 1 and 2), the US 2000 Notes, the US 2001 Notes or the US 2002 Notes and subordinate the security related thereto to any indebtedness and related security that may be incurred by Algonquin America in the future.

Default on US 2002 Notes

The US 2002 Notes provide that any of the following will constitute an event of default: (i) default in payment of the principal when due; (ii) default on any senior indebtedness for borrowed money; (iii) certain events of winding-up, liquidation, bankruptcy, insolvency, receivership, general assignment for the benefit of creditors or proceedings with respect to a compromise or arrangement under applicable bankruptcy or insolvency legislation; (iv) the taking of possession by an encumbrancer of all or substantially all of the property of Algonquin America; (v) ceasing to carry on in the ordinary course the business of Algonquin America; (vi) default in performing any material lease, licence or other agreement whereby any material property or rights of Algonquin America may be forfeited or terminated; (vii) default in the observance or performance of any other covenant or condition of the note and the continuance of such default for a period of 30 days after notice in writing has been given to Algonquin America specifying such default and requiring Algonquin America to rectify same; and (viii) final judgment(s) for the payment of money aggregating in excess of \$500,000 against

Algonquin America or any of its property and any one such judgment remains unpaid, unvacated, unbonded or unstayed for a period of 30 days after entry.

Loan Capital of Algonquin Water

Algonquin Water issued secured, subordinated notes (the “US Water 2002 Notes”) on May 23, 2002 in the principal amount of approximately \$19.6 million. Algonquin Water used the proceeds from the issuance of the US Water 2002 Notes in the amount of \$19.6 million to acquire the shares of Bella Vista Water Company, which owns a water utility located in Sierra Vista, Arizona. The US 2002 Water Notes are held, directly or indirectly, by the Fund.

Interest on US Water 2002 Notes

The US Water 2002 Notes bear interest at the rate of 7.1% per annum, payable monthly. The US Water 2002 Notes are due on March 16, 2041.

The interest and principal on the US Water 2002 Notes are payable in Canadian funds. The US Water 2002 Notes provide that Algonquin Water may defer payment of interest to the extent that its earnings before interest, taxes, depreciation and amortization are inadequate to pay the interest on such notes. Any interest deferred for a period exceeding 12 months will be capitalized as part of the principal outstanding under such notes, as applicable.

Redemption of US Water 2002 Notes

The principal amount of the US Water 2002 Notes will be retired prior to maturity from available cash after payment of interest on the US Water 2001 Notes and the US Water 2002 Notes. In any event, the principal amount of the US Water 2001 Notes and the US Water 2002 Notes remaining outstanding on the due date will be immediately due and payable by Algonquin Water.

Ranking of US Water 2002 Notes

The US Water 2001 Notes and the US Water 2002 Notes rank pari passu with each other. The US Water 2001 Notes and the US Water 2002 Notes are secured by all of the assets of Algonquin Water. At the discretion of Algonquin Water’s board of directors, Algonquin Water has the ability to postpone repayment of the US Water 2001 Notes and the US Water 2002 Notes and subordinate the security related thereto to any indebtedness and related security that may be incurred by Algonquin Water in the future.

Default on US Water 2002 Notes

The US Water 2002 Notes provide that any of the following will constitute an event of default: (i) default in payment of the principal when due; (ii) default on any senior indebtedness for borrowed money; (iii) certain events of winding-up, liquidation, bankruptcy, insolvency, receivership, general assignment for the benefit of creditors or proceedings with respect to a compromise or arrangement under applicable bankruptcy or insolvency legislation; (iv) the taking of possession by an encumbrancer of all or substantially all of the property of Algonquin Water; (v) ceasing to carry on in the ordinary course the business of Algonquin Water; (vi) default in performing any material lease, licence or other agreement whereby any material property or rights of Algonquin Water may be forfeited or terminated; (vii) default in the observance or performance of any other covenant or condition of the note and the continuance of such default for a period of 30 days after notice in writing has been given to Algonquin Water specifying such default and requiring Algonquin Water to rectify same; and (viii) final judgment(s) for the payment of money aggregating in excess of \$500,000 against Algonquin Water or any of its property and any one such judgment remains unpaid, unvacated, unbonded or unstayed for a period of 30 days after entry.

USE OF PROCEEDS

The net proceeds to the Fund from the sale of Trust Units, assuming the sale of all Trust Units available on a best efforts agency basis, are estimated to be approximately \$94,878,600, after deducting the fees payable to

the Underwriters and the estimated expenses of the offering. It is anticipated that the net proceeds will be used to (i) acquire an interest in additional facilities which satisfy the Acquisition Guidelines; (ii) repay debt; and (iii) for working capital.

Two of the Underwriters are subsidiaries of Canadian chartered banks which provided the Line of Credit to the Fund. Consequently, the Fund may be considered a connected issuer of those Underwriters under applicable Canadian securities legislation. See “Plan of Distribution” and “Share and Loan Capital”.

DETAILS OF THE OFFERING

The offering consists of up to 10,120,000 Trust Units. For a description of the attributes of the Trust Units, reference is made to the Annual Information Form in the section entitled “Development of the Business — Creation of the Fund and Declaration of Trust”.

The Trust Units of the Fund have been rated “SR-2 (High)” under the income fund stability and sustainability rating system established by Standard & Poor’s (“S&P”). The rating system managed by S&P is intended to rank the stability of an income fund’s cash distribution stream on the basis of volatility and sustainability. The scale utilized by S&P runs from SR-1 (Highest) to SR-7 (Very Low). Such rating is not a recommendation to buy, sell or hold Trust Units and it is subject to revision or withdrawal at any time by S&P.

The Fund carries a single A minus rating from S&P on its bank loan facility.

PLAN OF DISTRIBUTION

Under an underwriting agreement (the “Underwriting Agreement”) dated ● , 2002 between the Fund, the Manager and the Underwriters, the Fund has agreed to issue and sell and the Underwriters have severally agreed to purchase on or about October 16, 2002 or such other date as may be agreed upon, but not later than November 18, 2002, subject to the terms and conditions stated therein, 10,120,000 of the Trust Units offered hereby at a price of \$9.90 per Trust Unit, payable in cash, for aggregate consideration of \$100,188,000 to the Fund, against delivery. The Fund has agreed to pay the Underwriters a fee of \$0.495 per Trust Unit purchased by the Underwriters for their services in connection with this offering. The Trust Units are being sold as to 8,600,000 Trust Units on a firm underwritten basis and as to 1,520,000 Trust Units on a best efforts agency basis.

The obligations of the Underwriters under the Underwriting Agreement may be terminated at their discretion on the basis of their assessment of the state of the financial markets and may also be terminated upon the occurrence of certain stated events. The Underwriters are, however, severally obligated to take up and pay for all Trust Units agreed to be purchased under the Underwriting Agreement if any Trust Units are purchased under the Underwriting Agreement. Each of the Fund and the Manager has agreed to indemnify the Underwriters and their directors, officers, employees and agents against certain liabilities, including civil liabilities under Canadian provincial securities legislation, or will contribute to payments the Underwriters may be required to make in respect thereof.

Pursuant to policy statements of the Ontario Securities Commission and the Commission des valeurs mobilières du Québec, the Underwriters may not, throughout the period of distribution under this prospectus, bid for or purchase Trust Units. The foregoing restriction is subject to exceptions, including a bid or purchase permitted under the by-laws and rules of The Toronto Stock Exchange relating to market stabilization and passive market-making activities and a bid or purchase made for and on behalf of a customer where the order was not solicited during the period of distribution, provided that the bid or purchase is not engaged in for the purpose of creating actual or apparent active trading in, or raising the price of, the Trust Units. In connection with this offering, and subject to the foregoing, the Underwriters may effect transactions which stabilize or maintain the market price for the Trust Units at levels other than those which might otherwise prevail in the open market. Such transactions, if commenced, may be discontinued at any time.

The Trust Units have not been and will not be registered under the *United States Securities Act of 1933*, as amended, (the “US Securities Act”) and, subject to certain exemptions, may not be offered or sold within the United States. The Underwriters have agreed that they will not offer, sell or deliver the Trust Units offered hereby within the United States or to U.S. Persons except for sales pursuant to an exemption from registration under the US Securities Act. In addition, until 40 days after the commencement of this offering, an offer or sale

of additional Trust Units within the United States by any dealer (whether or not participating in this offering) may violate the registration requirements of the US Securities Act if such offer or sale is made other than pursuant to an exemption from registration under the US Securities Act.

The Fund has agreed that it will not, without the prior consent of BMO Nesbitt Burns Inc. pursuant to the Underwriting Agreement, which consent may not be unreasonably withheld or delayed, directly or indirectly, authorize, issue or sell any Trust Units or any securities giving the right to acquire Trust Units or agree or announce the intention to do so, at any time prior to the date 90 days following the closing.

It is expected that certificates for the Trust Units will be available for delivery on or about closing. The closing is expected to take place on or about October 16, 2002 but in any event not later than November 18, 2002.

National Bank Financial Inc. (“National”) and TD Securities Inc. (“TD”), two of the Underwriters, are wholly-owned subsidiaries of Canadian chartered banks which provided the Fund with the Line of Credit. Accordingly, the Fund could be considered a connected issuer of National and TD for purposes of the securities legislation of certain Canadian provinces. The decision of National and TD to underwrite the Trust Units was made independently of such banks and such banks have had no influence as to the determination of the terms of distribution. Each of National and TD will not receive any benefit in connection with this offering other than a portion of the Underwriters’ fee payable by the Fund. As of September 30, 2002, the Fund has approximately \$66.5 million of indebtedness outstanding under the Line of Credit, in addition to letters of credit aggregating approximately \$31.2 million. See “Share and Loan Capital”. Approximately \$70.0 million of the proceeds of this offering is anticipated to be used to pay down outstanding indebtedness on the Line of Credit.

The Fund will apply to list the Trust Units distributed under this short form prospectus on The Toronto Stock Exchange. Listing will be subject to the Fund fulfilling all the listing requirements of The Toronto Stock Exchange.

CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

Reference is made to the section entitled “Canadian Federal Income Tax Considerations” in the Annual Information Form. For purposes of this prospectus, all references to the date of the Annual Information Form contained in the section entitled “Canadian Federal Income Tax Considerations” therein should be read as the date of this prospectus.

ELIGIBILITY FOR INVESTMENT

Subject to certain assumptions, limitations and restrictions described in the section entitled “Canadian Federal Income Tax Considerations” in the Annual Information Form, in the opinion of Blake, Cassels & Graydon LLP, as of the date of this prospectus, the Trust Units are qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans under the *Income Tax Act* (Canada), are not foreign property for purposes of Part XI of the *Income Tax Act* (Canada) and are not precluded as investments under certain other statutes. Reference is made to the sections entitled “Eligibility for Investment” and “Canadian Federal Income Tax Considerations” in the Annual Information Form. For purposes of this prospectus, all references to the date of the Annual Information Form contained in such sections should be read as the date of this prospectus.

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Algonquin Power took the initiative in organizing the business and affairs of the Fund. The Manager and Power Systems are affiliates of Algonquin Power. Upon completion of the Reorganization, the Manager will hold certain shares of Algonquin Canada and Algonquin America. Reference is made to this section entitled “Algonquin Power Income Fund — Recent Developments”.

Effective July 1, 2002, the Manager and the Trustees on behalf of the Fund agreed upon certain revisions to the management compensation structure utilized in respect of the Fund. Under such new structure, the shareholders of the Manager will perform their respective management functions effectively as employees of the Fund. No acquisition fees or other transaction related compensation will be paid to the Manager in respect of

acquisitions. Reference is made to this section entitled “Algonquin Power Income Fund — Recent Developments”. Prior to the implementation of such revised compensation structure, the Fund completed the provision of debt financing to and the acquisition of all trust units and certain convertible debentures issued by the KMS Power Income Fund, the acquisition of the Sanger cogeneration facility assets and the purchase of all issued and outstanding shares of the Bella Vista Water Company for an aggregate transaction value of approximately \$204 million. In respect of these transactions, the Manager was paid fees in the aggregate of approximately \$2.24 million and received an additional \$195,000 in respect of reimbursement of internal acquisition related costs. Such acquisition related fees were calculated solely on the basis of the amount by which the cash distributions anticipated to be provided to the Fund from these facility interests exceeded the minimum accretion criteria of \$0.97 per Trust Unit established by the Trustees of the Fund.

Power Systems presently provides operations and supervisory related services to certain of the Fund businesses and all such services are provided on a cost reimbursement basis. The Manager will continue to provide management services with respect to the Fund businesses pursuant to the revised Management Agreement and will continue to provide administrative services to the Fund pursuant to the Administration Agreement and corporate governance services to Algonquin Holdco, Algonquin Canada, Algonquin America and the Algonquin Trust pursuant to the Governance Agreement; except for incentive fees calculated on the basis of increases in Distributable Cash per Trust Unit, all services provided by the Manager will be provided on a cost reimbursement basis. Pursuant to the Governance Agreement, the Manager is entitled to appoint two of Algonquin Canada’s and Algonquin Holdco’s three directors and two trustees of the Algonquin Trust. Reference is made to the section entitled “Algonquin Power Income Fund — Recent Developments”.

RISK FACTORS

Reference is made to the section entitled “Risk Factors” in the Annual Information Form.

LEGAL MATTERS

Certain legal matters relating to the issuance of the Trust Units to the public will be passed upon at closing by Blake, Cassels & Graydon LLP on behalf of the Fund and the Manager and by Cassels Brock & Blackwell LLP on behalf of the Underwriters. As of the date hereof, the partners and associates of Blake, Cassels & Graydon LLP own less than 1% of the issued and outstanding Trust Units of the Fund.

STATUTORY RIGHTS OF WITHDRAWAL AND RESCISSION

Securities legislation in certain of the provinces of Canada provides purchasers with the right to withdraw from an agreement to purchase securities. This right may be exercised within two business days after receipt or deemed receipt of a prospectus and any amendment. In several of the provinces, the securities legislation further provides a purchaser with remedies for rescission or, in some jurisdictions, damages if the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser’s province. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser’s province for the particulars of these rights or consult with a legal advisor.

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**PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS
COMPILATION REPORT**

To the Trustees of Algonquin Power Income Fund

We have reviewed, as to compilation only, the pro forma consolidated statements of earnings for Algonquin Power Income Fund (the "Fund") for the six months ended June 30, 2002 and the year ended December 31, 2001. These pro forma consolidated financial statements have been prepared for inclusion in the short form prospectus. In our opinion, the pro forma consolidated statements of earnings have been properly compiled to give effect to the transactions and the assumptions described in the notes thereto.

Toronto, Canada
September 30, 2002

(Signed) KPMG LLP
Chartered Accountants

ALGONQUIN POWER INCOME FUND
PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
For the six months ended June 30, 2002
(In thousands of Canadian dollars, except per unit amounts)

	Fund Historical (Period January 1 to June 30, 2002)	KMS Historical (Period January 1 to March 14, 2002)	Sanger Historical (Period January 1 to April 30, 2002)	Pro Forma Adjustments	Notes	Pro Forma Consolidated
Revenue						
Energy sales	32,989	2,439	8,075			43,503
Waste disposal fees	3,673	2,486	—			6,159
Water treatment revenue	2,942	—	—			2,942
Interest, dividend and other income	4,484	89	195	656	2 F	
				(656)	2 F	
				(195)	2 K	4,573
	<u>44,088</u>	<u>5,014</u>	<u>8,270</u>	<u>(195)</u>		<u>57,177</u>
Expenses						
Operating	15,972	3,517	6,103	(186)	2 H	25,406
Amortization	8,160	1,163	55	87	2 G	—
				592	2 M	10,057
Management fees	345	97	—	(97)	2 I	345
Administrative expenses	1,713	86	451	12	2 H	2,262
U.S. withholding tax	522	28	—			550
(Gain) loss on foreign exchange	(1,403)	—	—	186	2 H	(1,217)
Trustee fees	—	12	—	(12)	2 H	—
	<u>25,309</u>	<u>4,903</u>	<u>6,609</u>	<u>582</u>		<u>37,403</u>
Earnings before under noted	18,779	111	1,661	(777)		19,774
Interest expense	3,561	—	27	656	2 F	—
				(656)	2 F	—
				96	2 D	—
				296	2 L	3,980
Interest on convertible debentures	—	136	—	(64)	2 A	72
Other interest expense	—	668	—	(668)	2 B	—
Lease expense	—	—	3,297	(3,297)	2 K	—
Earnings before income taxes and minority interest	<u>15,218</u>	<u>(693)</u>	<u>(1,663)</u>	<u>2,860</u>		<u>15,722</u>
Provision for (recovery of) income taxes						
Current income taxes	208	—	—			208
Future income taxes	(1,546)	—	—			(1,546)
	<u>(1,338)</u>	<u>—</u>	<u>—</u>	<u>—</u>		<u>(1,338)</u>
Minority interest	118	—	—	(623)	2 J	(505)
Net earnings	<u>16,438</u>	<u>(693)</u>	<u>(1,663)</u>	<u>3,483</u>		<u>17,565</u>
Net earnings per trust unit						<u>\$ 0.31</u>

ALGONQUIN POWER INCOME FUND
PRO FORMA CONSOLIDATED STATEMENT OF EARNINGS
For the year ended December 31, 2001
(In thousands of Canadian dollars, except per unit amounts)

	<u>Fund Historical</u>	<u>KMS Historical</u>	<u>Sanger Historical</u>	<u>Pro Forma Adjustments</u>	<u>Notes</u>	<u>Pro Forma Consolidated</u>
Revenue						
Energy sales	37,290	11,307	26,762			75,359
Waste disposal fees	—	11,744	—			11,744
Water treatment revenue	2,522	—	—			2,522
Interest, dividend and other income	5,157	733	737	4,044	2 F	
				(4,044)	2 F	
				(737)	2 K	5,890
	<u>44,969</u>	<u>23,784</u>	<u>27,499</u>	<u>(737)</u>		<u>95,515</u>
Expenses						
Operating	14,829	15,239	15,640	191	2 H	45,899
Amortization	10,231	6,005	223	(7)	2 G	—
				1,719	2 M	18,171
Write down of capital asset	—	3,940	—			3,940
Management fees	337	873	—	(873)	2 I	337
Administrative expenses	792	734	2,071	60	2 H	3,657
U.S. withholding tax	472	134	—			606
(Gain) loss on foreign exchange	(354)	—	—	(191)	2 H	(545)
Trustee fees	—	60	—	(60)	2 H	—
	<u>26,307</u>	<u>26,985</u>	<u>17,934</u>	<u>839</u>		<u>72,065</u>
Earnings before under noted	18,662	(3,201)	9,565	(1,576)		23,450
Interest expense	6,700	—	381	4,044	2 F	
				(4,044)	2 F	
				419	2 D	
				2,557	2 L	10,057
Interest on long term debt	—	1,202	—	(1,202)	2 C	—
Interest on convertible debentures	—	810	—	(383)	2 A	427
Write down of financing fees	—	766	—	(766)	2 E	—
Other interest expense	—	276	—	(276)	2 B	—
Lease expense	—	—	9,795	(9,795)	2 K	—
Loan payment fee	6,751	—	—	—		6,751
Income from note receivable prepayment	(1,890)	—	—	—		(1,890)
Earnings before income taxes and minority interest	<u>7,101</u>	<u>(6,255)</u>	<u>(611)</u>	<u>7,870</u>		<u>8,105</u>
Provision for (recovery of) income taxes						
Current income taxes	391	—	5			396
Future income taxes	(154)	—	—			(154)
	<u>237</u>	<u>—</u>	<u>5</u>	<u>—</u>		<u>242</u>
Minority interest	—	—	—	(1,963)	2 J	(1,963)
Net earnings	<u>6,864</u>	<u>(6,255)</u>	<u>(616)</u>	<u>9,833</u>		<u>9,826</u>
Net earnings per trust unit						<u>\$ 0.21</u>

ALGONQUIN POWER INCOME FUND
NOTES TO PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS
(In thousands of Canadian dollars)

1. BASIS OF PRESENTATION

The accompanying pro forma consolidated statements of earnings of Algonquin Power Income Fund (the “Fund”) have been prepared by the management of Algonquin in accordance with Canadian generally accepted accounting principles.

The pro forma consolidated statements of earnings have been prepared from information derived from the:

- unaudited consolidated statement of earnings of the Fund for the six months ended June 30, 2002, which includes the operating results of:
 - KMS Power Income Fund (“KMS”) for the period March 15, 2002 to June 30, 2002; and
 - Sanger Power, L.L.C. (“Sanger”) for the period May 1, 2002 to June 30, 2002;
- audited consolidated statement of earnings of the Fund and KMS for the year ended December 31, 2001;
- audited statement of earnings of Dynamis, Inc. for the year ended July 31, 2001;
- unaudited consolidated statement of earnings of KMS for the three months ended March 31, 2002;
- unaudited statement of earnings of Dynamis, Inc. for the nine months April 30, 2002; and
- adjustments and assumptions outlined in note 2 below.

The pro forma consolidated statements of earnings may not be indicative of the results of operations that would have occurred if the acquisition and other pro forma adjustments had been in effect on the dates indicated or of the operating results which may be obtained in the future.

The pro forma consolidated statements of earnings should be read in conjunction with the unaudited consolidated financial statements of the Fund for the six months ended June 30, 2002 and the audited consolidated financial statements of the Fund and KMS for the year ended December 31, 2001, the unaudited consolidated financial statements of KMS for the three months ended March 31, 2002, the unaudited consolidated financial statements of Dynamis, Inc. for the nine months ended April 30, 2002 and the audited consolidated financial statements of Dynamis, Inc. for the year ended July 31, 2001.

The KMS Transaction

Under the terms of the KMS Transaction, the Fund:

- issued 6,099,557 trust units;
- entered into a credit agreement (the “Credit Agreement”) pursuant to which the Fund provided KMS with \$35,000 in debt financing. The Credit Agreement stipulates that the financing bears interest at a floating rate equal to 5.568% above the prime rate of interest; and
- incurred costs of \$3,899 including a termination fee of approximately \$1,943 to KMS Energy, Inc. (“KMS Energy”) to terminate the existing management agreement between KMS and KMS Energy;

in order to purchase 86.7% of the outstanding trust units of KMS and 47.3% of the 10% convertible debentures of KMS

Total consideration related to the KMS Transaction is summarized as follows:

• Trust units	\$ 62,704
• Loan Advance	35,000
• Cash	3,899
Total	<u>\$101,603</u>

ALGONQUIN POWER INCOME FUND
NOTES TO PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands of Canadian dollars)

1. BASIS OF PRESENTATION (Continued)

The purchase price paid by the Fund was allocated as follows:

Working capital	\$ (3,232)
Funds held in reserve	1,124
Capital assets	127,442
Long-term liabilities assumed	(6,775)
Minority interest	<u>(15,868)</u>
Total	<u>\$101,603</u>

The pro forma calculation and allocation of the purchase price discrepancy, representing the excess of the purchase price, including acquisition costs, over the related book value of the net assets acquired of KMS was allocated to property, plant and equipment and the related power purchase power agreements based on the fair value of the assets and liabilities purchased at the effective date of the KMS Transaction and other information available at that date.

The Sanger Transaction

Under the terms of the Sanger Transaction, the Fund:

- issued 248,667 trust units;
- paid \$46,854 in cash; and
- assumed long-term liabilities of \$30,223

in order to purchase a 43.5MW natural gas fired generating station, and related working capital assets, located in Sanger, California from Dynamis, Inc. and Viacom Inc., the lessor of the generating station.

Total consideration related to the Sanger Transaction is summarized as follows:

• Trust units	\$ 2,181
• Cash and assumed debt	46,854
• Long-term liabilities assumed	30,223
Total	<u>\$79,258</u>

The purchase price paid by the Fund was allocated as follows:

Working capital	\$ 648
Capital assets	78,610
Total	<u>\$79,258</u>

The pro forma calculation and allocation of the purchase price discrepancy, representing the excess of the purchase price, including acquisition costs, over the related book value of the net assets acquired from Sanger was allocated to property, plant and equipment and the related power purchase power agreements based on the fair value of the assets and liabilities purchased at the effective date of the Sanger Transaction and other information available at that date.

2. PRO FORMA ADJUSTMENTS AND ASSUMPTIONS — CONSOLIDATED STATEMENTS OF EARNINGS

The pro forma statements of consolidated earnings of the Fund for the six months ended June 30, 2002 and for the year ended December 31, 2001 are based on the historical financial statements of the Fund, KMS and Sanger as adjusted for the effects of the following adjustments based on the assumption that the KMS Transaction and the Sanger Transaction occurred on January 1, 2002 and January 1, 2001 respectively.

ALGONQUIN POWER INCOME FUND
NOTES TO PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands of Canadian dollars)

2. PRO FORMA ADJUSTMENTS AND ASSUMPTIONS — CONSOLIDATED STATEMENTS OF EARNINGS (Continued)

KMS Transaction

The following adjustments were applied to the statement of earnings of KMS for the period January 1, 2002 to March 14, 2002 and the year ended December 31, 2001:

- a) elimination of the Fund's share of interest expense on the liability portion of the convertible debentures of \$64 for the period ended March 14, 2002 (\$383 for the year ended December 31, 2001);
- b) elimination of interest expense on other indebtedness of \$668 for the period ended March 14, 2002 (\$276 for the year ended December 31, 2001) due to the earlier repayment of outstanding debt with \$35,000 loan advance;
- c) elimination of interest on long term debt of \$1,202 for the year ended December 31, 2001 due to the earlier repayment of outstanding debt with \$35,000 loan advance;
- d) inclusion of imputed interest on a subsidy payable of \$96 for the period ended March 14, 2002 (\$419 for the year ended December 31, 2001) discounted by the Fund in fair valuing the acquisition;
- e) elimination of the write down of financing fees of \$766 for the year ended December 31, 2001 due to the earlier repayment of outstanding debt with \$35,000 loan advance;
- f) recognition of intercompany interest expense related to the Credit Agreement of \$656 for the period ended March 14, 2002 (\$4,044 for the year ended December 31, 2001) and elimination of such interest on the consolidation of the Fund and KMS;
- g) adjustment of amortization expense related to capital assets as a result of the adoption of the Fund's accounting policy for depreciation of capital assets and the elimination of amortization of KMS' goodwill offset by the fair value increment allocated to capital assets;
- h) re-allocation of the foreign exchange loss and trustee fees of KMS to conform to the Fund's presentation;
- i) elimination of \$97 in management fees for the period ended March 14, 2002 (\$873 for the year ended December 31, 2001) due to the termination of the existing management agreement with KMS Energy;
- j) allocation of the minority interest share of KMS net income after reflecting the above noted adjustments and the equity component of the convertible debt.

The convertible debentures of KMS have both debt and equity features and the classification on KMS' balance sheet was appropriately split. Interest paid on the debentures was similarly split between interest expense in the statements of earnings and a portion reported as a charge against equity. The portion of interest charged against equity for the six months ended June 30, 2002 was \$1,158 (\$2,190 for the year ended December 31, 2001).

Sanger Transaction

The following adjustments were applied to the statement of earnings of Dynamis, Inc. for the period January 1, 2002 to April 30, 2002 and the year ended December 31, 2001:

- k) elimination of lease expense of \$3,297 and \$195 amortization of deferred gain for the period ended March 14, 2002 (\$9,795 and \$737 for the year ended December 31, 2001) associated with the sale — lease back transaction which was structured between Dynamis and Viacom Inc.;
- l) addition of interest expense of \$296 for the period ended March 14, 2002 (\$2,557 for the year ended December 31, 2001) incurred in relation to financing the Sanger Transaction by borrowing on the Fund's line of credit; and
- m) adjustment of amortization expense related to capital assets as a result of the fair value increment related to the capital assets.

3. PRO FORMA CONSOLIDATED BALANCE SHEET

The Fund's consolidated financial statements as at June 30, 2002 included the consolidated accounts of all of its subsidiaries, including KMS and Sanger.

DYNAMIS, INC.

FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED APRIL 30, 2002 and 2001

DYNAMIS, INC.
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INDEPENDENT ACCOUNTANTS' REPORT

To the Board of Directors
Dynamis, Inc.

We have reviewed the balance sheet of Dynamis, Inc. (a wholly-owned subsidiary of DAF-California, Inc.) as of April 30, 2002 and 2001, and the related statements of operations and accumulated deficit, and cash flows for the nine months ended April 30, 2002 and 2001, in accordance with Statements on Standards for Accounting and Review Services. All information included in these financial statements is the representation of the management of Dynamis, Inc.

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

(Signed) "PKF"

San Diego, California
September 10, 2002

PKF
Certified Public Accountants
A Professional Corporation

DYNAMIS, INC.
BALANCE SHEETS
April 30, 2002 and 2001

ASSETS

	2002	2001
Current assets:		
Cash and cash equivalents (Note 1)	\$ 333,581	\$ 599,736
Accounts receivable	1,297,715	335,214
Inventories (Note 3)	168,781	93,284
Prepaid expenses and deposits	36,952	8,316
Total current assets	1,837,029	1,036,550
Long-term receivable (Note 4)	—	3,884,475
Property and equipment, net (Note 1)	113,853	248,617
Restricted cash and cash equivalents (Note 2)	5,531,947	4,347,865
Deferred income taxes	2,100,000	2,100,000
Other assets	117,433	121,029
Deferred charges (Note 5)	1,559,710	2,107,459
Total assets	\$11,259,972	\$13,845,995

The accompanying notes are an integral part of the financial statements.

DYNAMIS, INC.
BALANCE SHEETS (Continued)
April 30, 2002 and 2001

LIABILITIES AND SHAREHOLDER'S EQUITY

	2002	2001
Current liabilities		
Current maturities of long-term obligations	\$ 407,532	\$ 400,806
Accounts payable	312,638	396,911
Accrued liabilities	1,008,756	1,207,778
Lease payable	1,043,636	1,020,926
Due to affiliated companies	680,064	804,441
Current portion of capital lease obligation	9,427	8,500
Total current liabilities	3,462,053	3,839,362
Long-term payable (Note 4)	—	2,498,000
Deferred gain on the sale of plant and equipment (Note 7)	2,595,703	2,873,815
Long-term obligations (Note 8)	1,783,054	1,944,289
Capital lease obligation, net of current portion (Note 9)	15,507	28,227
Commitments and contingencies (Note 11)		
Shareholder's equity:		
Common stock, \$1 par value, 11,000 shares authorized; 3,000 shares issued and outstanding	3,000	3,000
Additional contributed capital	8,700,841	8,700,841
Accumulated deficit	(5,300,186)	(6,041,539)
Total shareholder's equity	3,403,655	2,662,302
Total liabilities and total shareholder's equity	\$11,259,972	\$13,845,995

(Signed) "MICHEL GAUCHER"
Director

(Signed) "J.F. RABOULLI"
Director

See accountants' review report and accompanying notes to the financial statements.

DYNAMIS, INC.
STATEMENTS OF OPERATIONS AND ACCUMULATED DEFICIT
For the Nine Months Ended April 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Revenues:		
Energy sales	\$12,237,062	\$ 9,893,653
Hydraulic mulch	1,513,969	1,296,129
Amortization of deferred gain	208,583	208,583
Total revenue	<u>13,959,614</u>	<u>11,398,365</u>
Costs and expenses:		
Cost of sales	7,792,191	7,484,607
Repairs and maintenance	119,757	17,593
Depreciation and overhaul amortization	100,427	124,392
Selling, general and administrative	1,007,338	834,697
Total costs and expenses	<u>9,019,713</u>	<u>8,461,289</u>
Income before lease expense, other income (expense), and income taxes	4,939,901	2,937,076
Lease expense	4,634,897	4,879,450
Other income (expense):		
Other income	101,477	285,044
Other expense, primarily interest expense	(189,208)	(218,027)
Other expense	(156,592)	(5,870)
Total other (expense) income	<u>(244,323)</u>	<u>61,147</u>
Income (loss) before income taxes	60,681	(1,881,227)
Income taxes	(3,200)	(3,200)
Net income (loss)	<u>57,481</u>	<u>(1,884,427)</u>
Accumulated deficit — beginning	<u>(5,357,667)</u>	<u>(4,157,112)</u>
Accumulated deficit — ending	<u><u>\$ (5,300,186)</u></u>	<u><u>\$ (6,041,539)</u></u>

See accountants' review report and accompanying notes to the financial statements.

DYNAMIS, INC.
STATEMENTS OF CASH FLOWS
For the Nine Months Ended April 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net income (loss)	\$ 57,481	\$(1,884,427)
Adjustments to reconcile net income (loss) to net cash used in by operating activities:		
Amortization of gain on sale	(208,583)	(208,583)
Depreciation and amortization	10,427	13,894
(Increase) decrease in assets:		
Accounts receivable	3,419,479	(651,919)
Inventories	(6,157)	180,082
Prepaid expenses and deposits	(18,443)	326,005
Deferred charges	(833,719)	(791,408)
Other assets	2,020	1,126
Increase (decrease) in liabilities:		
Accounts payable	(2,880,598)	2,068,568
Accrued liabilities	(11,699)	226,517
Due to affiliated companies	(133,361)	571,530
Net cash flows used in operating activities	<u>(603,153)</u>	<u>(148,615)</u>
Cash flows from investing activities:		
Changes in restricted cash and cash equivalents	<u>(1,387,955)</u>	<u>(247,204)</u>
Net cash flows used in investing activities	<u>(1,387,955)</u>	<u>(247,204)</u>
Cash flows from financing activities:		
Repayments of long-term obligations	(154,509)	(135,000)
Repayments on capital leases	<u>(6,668)</u>	<u>(3,352)</u>
Net cash flows used in financing activities	<u>(161,177)</u>	<u>(138,352)</u>
Net decrease in cash and cash equivalents	(2,152,285)	(534,171)
Cash and cash equivalents at beginning of period	2,485,866	1,133,907
Cash and cash equivalents at end of period	<u>\$ 333,581</u>	<u>\$ 599,736</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	<u>\$ 108,304</u>	<u>\$ 269,670</u>
Income taxes	<u>\$ 3,200</u>	<u>\$ 3,200</u>

See accountants' review report and accompanying notes to the financial statements.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS
For the Nine Months Ended April 30, 2002 and 2001

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business

Dynamis, Inc. (“Dynamis”) is a wholly owned subsidiary of DAF-California, Inc. (“DAF”). Dynamis operates a natural gas fired cogeneration facility and a thermal host-user, which manufactures hydraulic mulch used in landscaping. The facility is located in Sanger, California and has a July 31 fiscal year end. The cogeneration facility generates electricity for sale to Pacific Gas & Electric Company (“PG&E”) pursuant to a long-term power purchase agreement. The steam generated from the cogeneration process is sold/transferred to the adjacent thermal host user.

Basis of Accounting

The Company’s policy is to use the accrual method of accounting and to prepare and present financial statements in accordance with accounting principles generally accepted in the United States of America. All figures are presented in US dollars. These accounting principles do not differ in any material respects from accounting principles generally accepted in Canada.

The accompanying financial statements have been prepared as of and for the period ended April 30, 2002 prior to the sale of assets of Dynamis as described in Note 14.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Inventory

Inventory consists of hydraulic mulch in various stages of production, and is stated at the lower of cost (determined on a first-in, first-out basis) or market.

Property and Equipment

Property and equipment are stated at cost. The double-declining balance method of depreciation is followed for substantially all assets for financial reporting and tax purposes. There is approximately \$260,000 in fully depreciated land improvements and \$24,800 in fully depreciated tools and equipment that are still in use.

Expenditures for maintenance, repairs and minor renewals are charged to operations as incurred. Expenditures for major maintenance shutdowns are capitalized and charged to operations on a straight-line basis over the period benefited by the major maintenance shutdown (usually three years).

Property and equipment consisted of the following as of April 30:

	2002	2001
Land	\$ 50,000	\$167,788
Land improvement	333,744	333,744
Furniture and equipment	70,401	70,401
	454,145	571,933
Less accumulated depreciation	(340,292)	(323,316)
Property and equipment	\$113,853	\$248,617

Reclassification

Certain prior year amounts have been reclassified to conform to the current year’s presentation.

Deferred Gain

The Company amortizes its deferred gain on the sale of its cogeneration facility under a sale-leaseback over the term of the lease on a straight-line basis.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Nine Months Ended April 30, 2002 and 2001

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Major Customer

All of the Company's electrical generation sales are to the local California Public Utility Company, Pacific Gas & Electric Company, under a 30-year standard offer power purchase agreement ("PPA"), which expires in the year 2022.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

NOTE 2 — RESTRICTED CASH AND CASH EQUIVALENTS

Under terms of the sale-leaseback agreement entered into with Chemical Bank (Note 7), certain funds are restricted which are designed for the fulfillment of various terms, operating cash requirements and construction requirements of the sale-leaseback agreement. These funds are controlled by banks under the terms of a trust agreement entered into as a part of the sale-leaseback transaction.

NOTE 3 — INVENTORIES

Inventories consist of the following as of April 30:

	2002	2001
Raw materials	\$ 67,799	\$93,284
Finished goods	100,982	—
	\$168,781	\$93,284

Certain amounts of the Company's raw materials are obtained from a limited number of suppliers.

NOTE 4 — LONG TERM RECEIVABLES AND PAYABLES

On December 21, 1990, the Company entered into Amendment 4 of its Standard Offer 2 Power Purchase Agreement with PG&E to supply firm capacity and energy for a period of 30 years commencing on May 1, 1991 through April 30, 2022. In 1997, California instituted deregulation of the electricity industry. Under deregulation, PG&E was forced to divest itself of much of its internal generation capacity and purchase, from the Power Exchange (PX), any shortfall between retail consumer demand and what it could produce through its' remaining internal generation capabilities or procure through existing power purchase agreements from Qualified Facilities (QF's) or Small Power Producers. During the fourth quarter of 2000, the California energy market experienced dramatic increases in the cost of natural gas due to shortages in supply and transmission constraints. As a result, the cost to PG&E of purchasing electricity on the wholesale market from the PX increased dramatically without a rate increase approved by the California Public Utility Commission (CPUC) that PG&E could charge back to its' retail customers.

In January 2001, PG&E notified the Company that it did not have sufficient funds to pay for firm capacity and energy payments in accordance with the PPA. PG&E paid 15% of amounts owed to the Company and proposed to pay the balance of the claim plus interest at a later date. On April 6, 2001, citing failure of the CPUC to permit PG&E recovery of its' cost to procure the wholesale electricity purchases from the PX, PG&E filed for Chapter 11 Federal Bankruptcy Court Protection.

During April 2001, PG&E filed for protection under Chapter 11 of the U.S. Bankruptcy Code. Under the bankruptcy court protection, PG&E began to make full payments on a going forward basis from the petition date of April 6, 2001 for firm capacity and energy

DYNAMIS, INC.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

For the Nine Months Ended April 30, 2002 and 2001

NOTE 4 — LONG TERM RECEIVABLES AND PAYABLES (Continued)

delivered to it from the Company. On July 14, 2001, the Company entered into Amendment 5 of the PPA and on July 27, 2001, the United States Bankruptcy Court ordered the assumption of the PPA by PG&E. Under the terms of Amendment 5, (1) the PPA will continue through its' original term until April 30, 2022, (2) PG&E will pay the Company a five-year average fixed energy price of 5.37 cents/kwh from September 1, 2001 through July 15, 2006 in accordance with CPUC issued Decision No. 01-06-015, (3) PG&E and the Bankruptcy Court recognize all pre-petition payables due the Company, totalling \$3,884,475 plus accrued interest, as an administrative expense with administrative privilege. The Company's administrative claim will be payable upon approval of the PG&E reorganization plan by the creditors and the Bankruptcy Court. If however, the approval of the Reorganization plan has not occurred by July 15, 2003, PG&E will pay the Company 2% of the total cure amount monthly until July 15, 2005, at which time all remaining cure amounts will be paid in full.

Consequently, the Company considers the amount receivable from PG&E of \$3,884,475 as a long term receivable, as well as the amount of \$2,637,564 (representing the gas amount to be paid to Natural Gas against the PG&E receivable) as a long term payable.

On March 16, 2001, the Company's natural gas supplier, Dynegy, entered into Payment Arrangements for amounts owed by the Company totalling approximately \$2,498,800 for natural gas purchases in December 2000 and January 2001. Under the Payment Arrangements, the Company will make progress payments for 85% of amounts it receives from PG&E for December 2000 or January 2001 power deliveries up to the total of amounts due Dynegy with accrued interest.

Prior to July 31, 2001, the Company began exploring the sale of its long term receivable from PG&E. On November 21, 2001, the Company entered into an agreement with an unrelated third party whereby the third party agreed to pay Dynamis \$3,496,028 in exchange for the Company's right to receive \$3,884,475 from PG&E. In addition, the third party is entitled to receive any interest or additional payments made on the above receivable as a result of the Reorganization Plan. On December 7, 2001, a Notice of Transfer of Administrative claim was filed in the United States Bankruptcy Court. The transfer of funds for this agreement took place on December 21, 2001. This discount was recorded during the fiscal quarter ended July 31, 2001.

On November 21, 2001, the Company entered into an agreement with Dynegy whereby Dynegy agreed to accept \$2,300,000 in full payment of the outstanding obligation owed by the Company totalling \$2,498,000. On December 26, 2001, the Company transferred funds in full settlement of this obligation. The Company recorded the gain associated with this debt forgiveness during the quarter ended July 31, 2001. The discount on the sale of the receivable and settlement of the obligation were recorded in the same period based on the payments due to Dynegy being due upon the receipt of payment for amounts owed by PG&E.

NOTE 5 — DEFERRED CHARGES

Deferred charges consist principally of the excess of actual lease payments made for the sale-leaseback, described in Note 7, over the straight-line lease expense. See Note 14.

NOTE 6 — CONCENTRATION OF CREDIT RISK

The Company has concentrated its credit risk for cash by maintaining deposits in two banks. The maximum losses that could have resulted from that risk for the excess of the deposit liabilities reported by the bank over the amounts covered by federal insurance was approximately \$133,381 and \$399,536 at April 30, 2002 and 2001, respectively. The Company has not experienced any losses in such accounts and management believes it places its cash on deposit with financial institutions which are financially stable. Other significant concentrations of credit risk are significant receivables that are due from PG&E.

NOTE 7 — DEFERRED GAIN ON SALE

On December 15, 1990, the Company entered into a sale-leaseback of a self constructed natural gas fired cogeneration facility with Chase Manhattan Bank and Trust and leased the facility back for a period of twenty years at an average annual rental of \$6,290,000 per year. Chase Manhattan Bank and Trust simultaneously entered into a Trust Participant Agreement with Viacom, formerly Westinghouse Credit Corporation, whereby ownership was transferred.

The Company invested approximately \$56,400,000 for construction of the plant, including \$2,220,294 of interest, which had been capitalized to the cost of the plant. The Company sold the plant in 1991 to Chase Manhattan Bank and Trust, formerly Chemical Bank, for \$67,400,000 resulting in a gain of approximately \$6,110,621 after financing and closing costs.

The resulting gain was deferred under sale-leaseback accounting and is being amortized on a straight-line basis over the term of the lease. See Note 14.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Nine Months Ended April 30, 2002 and 2001

NOTE 8 — LONG TERM OBLIGATIONS

Long-term obligations consist of the following as of April 30:

	2002	2001
Mello-Roos obligations	\$1,825,000	\$1,965,000
Subordinated debt	254,626	254,626
Obligations to the City of Sanger	110,960	125,469
	2,190,586	2,345,095
Less: current portion	(407,532)	(400,806)
	\$1,783,054	\$1,944,289

Aggregate payments for these obligations are as follows:

Year ending April 30:	
2003	\$ 407,532
2004	159,398
2005	170,808
2006	177,429
2007	189,294
Thereafter	1,086,125
	\$2,190,586

The Company entered into an agreement with the City of Sanger to finance public improvements to property adjacent to or within the plant facility, under the provisions of the Mello-Roos Community Facilities Act of 1982. Total proceeds of the financing were \$2,410,000. On June 1, 1998, the original bonds were restructured. Total proceeds of the new bond financing were \$2,225,000. See Note 14.

The Company entered into a subordinated debt agreement (“Note”) with Kendall Capital, for \$254,626 for fees owed for services rendered relating to the sale-leaseback transaction. Interest accrues at a prime rate, 6.75% and 9.5% as of July 31, 2001 and 2000, respectively, plus 4% and is payable quarterly. Principal payments are dependent on the operating income of the energy division of the Company, but will not be greater than \$18,188 per payment period. Principal payments are due semi-annually. Since the inception of this Note no principal or interest payments have been made. Management and its legal counsel are of the opinion that payments under the Note are only due from the excess cash flow derived from the Company, as described in the Note. Since the inception of the Note, no excess cashflow has been generated and management is of the opinion that excess cashflow, as described in the Note, is unlikely to be generated in the future under the current financing structure. See Note 14.

The Company entered into an agreement with the City of Sanger for payment of certain fees payable in various amounts over the next twenty years as a condition of obtaining operating permits. This obligation has been treated as a cost of construction of the power plant and discounted at the Company’s cost of funds, which was 15% at the time the agreement was entered into. See Note 14.

NOTE 9 — CAPITAL LEASE OBLIGATION

Capital lease obligation consists of the following as of April 30, 2002 and 2001:

	2002	2001
Capital lease obligation with interest and principal payable in monthly installments of approximately \$991. The capital lease obligation is secured by the related equipment. The capital lease obligation is due in December 2004.	\$24,934	\$36,727
Less: Current portion	(9,427)	(8,500)
Capital lease obligation, long-term	\$15,507	\$28,227

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Nine Months Ended April 30, 2002 and 2001

NOTE 9 — CAPITAL LEASE OBLIGATION (Continued)

Aggregate maturities of capital lease obligations as of April 30, 2002, are as follows:

	Amount
Year ended April 30:	
2003	\$11,898
2004	11,898
2005	4,498
Total minimum lease payments	28,294
Less: Amount representing interest	(3,360)
	\$24,934

Capitalized lease included in property and equipment amounted to approximately \$45,600 before accumulated amortization of \$27,726 and \$16,758 as of April 30, 2002 and 2001, respectively. Included in depreciation and amortization expense is amortization of capital lease assets in the amounts of approximately \$7,661 and \$9,918 for the periods ended April 30, 2002 and 2001, respectively.

NOTE 10 — TRANSACTION WITH AFFILIATES

Groupe Dynamis, a Canadian company related to the Company's shareholder, charges certain costs and expenses, primarily general and administrative, to the Company. Total costs and expenses charged to the Company totalled approximately \$72,000 for each of the periods ended April 30, 2002 and 2001.

NOTE 11 — COMMITMENTS AND CONTINGENCIES

The Company conducts a substantial portion of its operations utilizing leased facilities and equipment consisting of the electrical cogeneration power plant, administrative office space, office furniture and computer equipment, and vehicles. Some of the operating leases provide that the Company pays taxes, maintenance, insurance and other occupancy expense applicable to leased premises. Generally, the leases provide for renewal for various periods at stipulated rates.

During the year ended July 31, 1997, the facility and equipment lease agreement was amended, to provide among other things, for the payment of an unscheduled lease payment totalling \$7,700,000 and for the conversion of the animal feed production facility into a hydro-mulch facility. For future years, the Company will deduct the \$7,700,000 lease prepayment over the remaining life of the lease term for both federal and California income tax purposes. In addition, the agreement provides for the payment of future additional unscheduled rent payments depending upon the accumulation of excess funds. Such unscheduled lease payments allow the lessor the right to reprice future scheduled lease payments to maintain original rates of return under the lease. During the nine months ended April 30, 2002 and 2001, scheduled rent payments were repriced based on excess rents paid.

Minimum lease commitments at April 30, 2002 for this lease are approximately \$6,100,000 per year terminating 2011. See Note 14.

Total rent expense for the period ended April 30, 2002 and 2001 was \$4,634,897 and \$4,879,450, respectively. Cash rent payments for the period ended April 30, 2002 and 2001, respectively, totalled \$5,745,909 and \$5,449,324.

During 1998, the Company entered into a Gas Transmission Service Agreement — Transportation Service contract which requires the Company to pay approximately \$8,500 per month for transportation of natural gas to the Company's facility. This agreement remains in force until December 31, 2002.

The Company is required to maintain its Qualified Facility ("QF") status as imposed by regulatory and contractual requirements. If the QF status is not maintained, certain penalties may be imposed and/or contractual agreements modified. The Company believes that it was in compliance with the requirements to maintain its QF status during the periods ended April 30, 2001 and 2000.

DynaFibers, Inc. (a wholly owned subsidiary of DAF-California, Inc.), an inactive corporation, assigned its rights and obligations under a hydro-mulch product sales agreement to Dynamis.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Nine Months Ended April 30, 2002 and 2001

NOTE 12 — INCOME TAXES

Deferred income taxes reflect the net tax effects of the temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. The tax effect of temporary differences consisted of the following as of April 30:

	<u>2002</u>	<u>2001</u>
Deferred tax assets:		
Net operating loss carryforwards	\$ 2,063,000	\$ 2,431,000
Deferred gain on plant sale	923,000	1,117,000
Differences in lease expense recognition	852,000	948,000
Other	183,000	192,000
Gross deferred tax assets	<u>4,021,000</u>	<u>4,688,000</u>
Deferred tax liabilities:		
Property and equipment	(8,000)	(7,000)
Less: Valuation allowance	(1,913,000)	(2,581,000)
Net deferred tax assets	<u>\$ 2,100,000</u>	<u>\$ 2,100,000</u>

Realization of deferred tax assets is dependant upon sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income. As the achievement of required future taxable income is uncertain, the Company recorded a valuation allowance. The valuation allowance decreased by \$668,000 from 2001 and increased by \$819,000 from 2000. See Note 14.

As of April 30, 2002 and 2001, the Company has net operating loss carryforwards for both federal and state income tax purposes. Federal and state net operating loss carryforwards totalling approximately \$5,646,000 and \$2,450,000, begin to expire in 2011 and 2002, respectively. See Note 14.

The principal types of temporary difference, which are measured at the current tax rates, are deferred gain on the sale of plant and equipment, deferred rent, the lease prepayment, amortization and net operating loss carryforwards.

The provision for income taxes are follows as of April 30:

	<u>2002</u>	<u>2001</u>
Current	\$(3,200)	\$(3,200)
Deferred non-current	—	—
Total income tax expense	<u>\$(3,200)</u>	<u>\$(3,200)</u>

NOTE 13 — EMPLOYEE BENEFIT PLAN

The Company has a defined contribution 401(k) tax saving plan for all employees. The Company's contribution expense to the 401(k) plan for the periods ended April 30, 2002 and 2001 was approximately \$20,500 and \$22,482, respectively. The plan is available to full-time employees after a five-month vesting period. The maximum contribution percentage per employee is 15%. The Company will match up to 4% of the employee's salary.

NOTE 14 — SALE OF ASSETS

Effective May 1, 2002, the Company closed an agreement for the sale of substantially all of the assets of Dynamis, Inc. (Asset Sale) to an unrelated third party. In association with this Asset Sale, the acquiring company acquired most of the current assets and liabilities associated with the operations of the facility, assumed the lease obligation described in Note 11, the prepaid rent resulting from payments under this lease and the lease payable balance of approximately \$1,043,000 recorded in the statement of liabilities and shareholder's equity at April 30, 2002. The acquiring company also assumed the City of Sanger and Mello-Roos obligations described in Note 8. The restricted cash and investments related to various reserve requirements were retained by Dynamis, Inc.

As a result of the Asset Sale, the Company will recognize the remaining deferred gain on sale described in Note 7 and accordingly, will be utilizing a substantial portion of the deferred tax assets currently recorded in the financial statements.

DYNAMIS, INC.

FINANCIAL STATEMENTS

FOR THE YEARS ENDED JULY 31, 2001, 2000 and 1999

DYNAMIS, INC.
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Dynamis, Inc.

We have audited the balance sheets of Dynamis, Inc. (a wholly-owned subsidiary of DAF-California, Inc.) as of July 31, 2001, 2000 and 1999, and the related statements of operations, shareholder's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dynamis, Inc. as of July 31, 2001, 2000 and 1999, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

(Signed) "Pannell Kerr Forster"

San Diego, California
November 8, 2001 (except for Note 14 as to
which the date is January 16, 2002)

PANNELL KERR FORSTER
Certified Public Accountants
A Professional Corporation

DYNAMIS, INC.
BALANCE SHEETS
July 31, 2001, 2000 and 1999

ASSETS

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Current assets:			
Cash and cash equivalents (Note 2)	\$ 2,485,866	\$ 1,133,907	\$ 1,169,266
Accounts receivable	1,221,166	3,567,770	3,121,616
Inventories (Note 3)	162,624	273,366	157,268
Prepaid expenses and deposits	18,509	64,321	18,804
Total current assets	<u>3,888,165</u>	<u>5,039,364</u>	<u>4,466,954</u>
Long term receivable (Note 4)	3,496,028	—	—
Property and equipment, net (Note 1)	124,280	262,510	269,059
Restricted cash and cash equivalents (Note 2)	4,143,992	4,100,661	4,100,668
Deferred income taxes	2,100,000	2,100,000	2,100,000
Other assets	119,453	122,155	108,276
Deferred charges (Note 5)	725,991	1,586,051	1,917,593
Total assets	<u>\$14,597,909</u>	<u>\$13,210,741</u>	<u>\$12,962,550</u>

The accompanying notes are an integral part of the financial statements.

DYNAMIS, INC.
BALANCE SHEETS (Continued)
July 31, 2001, 2000 and 1999

LIABILITIES AND SHAREHOLDER'S EQUITY

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Current liabilities			
Current maturities of long-term obligations	\$ 407,912	\$ 395,806	\$ 406,739
Accounts payable	753,672	826,339	645,636
Accrued liabilities	1,020,455	981,261	697,663
Lease payable	1,043,636	1,020,926	1,134,638
Due to affiliated companies	813,425	232,911	70,873
Current portion of capital lease obligation	8,891	7,878	—
Total current liabilities	<u>4,047,991</u>	<u>3,465,121</u>	<u>2,955,549</u>
Long-term payable (Note 4)	2,439,564	—	—
Deferred gain on the sale of plant and equipment (Note 7)	2,804,286	3,082,397	3,360,508
Long-term obligations (Note 8)	1,937,183	2,084,289	2,225,469
Capital lease obligation, net of current portion (Note 9)	22,711	32,201	—
Commitments and contingencies (Note 11)			
Shareholder's equity:			
Common stock, \$1 par value, 11,000 shares authorized; 3,000 shares issued and outstanding	3,000	3,000	3,000
Additional contributed capital	8,700,841	8,700,841	8,700,841
Accumulated deficit	<u>(5,357,667)</u>	<u>(4,157,108)</u>	<u>(4,282,817)</u>
Total shareholder's equity	<u>3,346,174</u>	<u>4,546,733</u>	<u>4,421,024</u>
Total liabilities and total shareholder's equity	<u>\$14,597,909</u>	<u>\$13,210,741</u>	<u>\$12,962,550</u>

(Signed) "MICHEL GAUCHER"
 Director

(Signed) "J.F. RABOULLI"
 Director

The accompanying notes are an integral part of the financial statements.

DYNAMIS, INC.
STATEMENTS OF OPERATIONS
For the Years Ended July 31, 2001, 2000 and 1999

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Revenues:			
Energy sales	\$15,488,915	\$12,057,226	\$10,998,490
Hydraulic mulch	1,746,616	2,001,999	1,691,059
Amortization of deferred gain	278,111	278,111	278,111
Total revenue	<u>17,513,642</u>	<u>14,337,336</u>	<u>12,967,660</u>
Costs and expenses:			
Cost of sales	11,109,597	7,116,101	5,756,167
Repairs and maintenance	23,690	117,644	155,630
Depreciation and overhaul amortization	140,442	82,151	540,023
Selling, general and administrative	902,411	605,926	959,868
Total costs and expenses	<u>12,176,140</u>	<u>7,921,822</u>	<u>7,411,688</u>
Income before lease expense, other income (expense), extraordinary item and income taxes	5,337,502	6,415,514	5,555,972
Lease expense	6,405,131	6,370,562	6,185,949
Other income (expense):			
Other income	304,904	318,307	318,318
Other expense, primarily interest expense	(244,187)	(233,885)	(487,502)
Other expense, discount on sale of long-term receivable (Note 14)	(388,447)	—	—
Total other (expense) income	<u>(327,730)</u>	<u>(84,422)</u>	<u>(169,184)</u>
(Loss) income before extraordinary item and income taxes . . .	(1,395,359)	129,374	(799,161)
Extraordinary item			
Debt forgiveness, net of taxes of \$0	198,000	—	—
(Loss) income before income taxes	<u>(1,197,359)</u>	<u>129,374</u>	<u>(799,161)</u>
Income taxes	(3,200)	(3,665)	(38,619)
Net (loss) income	<u>\$ (1,200,599)</u>	<u>\$ 125,709</u>	<u>\$ (837,780)</u>

The accompanying notes are an integral part of the financial statements.

DYNAMIS, INC.
STATEMENTS OF SHAREHOLDER'S EQUITY
For the Years Ended July 31, 2001, 2000 and 1999

	Common Stock		Additional Contributed Capital	Accumulated Deficit	Total
	Shares	Amount			
Balance, July 31, 1998	3,000	\$3,000	\$8,700,841	\$(3,445,037)	\$5,256,804
Net loss	—	—	—	(837,780)	(837,780)
Balance, July 31, 1999	3,000	3,000	8,700,841	(4,282,817)	4,421,024
Net income	—	—	—	125,709	125,709
Balance, July 31, 2000	3,000	3,000	8,700,841	(4,157,108)	4,546,733
Net loss	—	—	—	(1,200,559)	(1,200,559)
Balance, July 31, 2001	<u>3,000</u>	<u>\$3,000</u>	<u>\$8,700,841</u>	<u>\$(5,357,667)</u>	<u>\$3,346,147</u>

The accompanying notes are an integral part of the financial statements.

DYNAMIS, INC.
STATEMENTS OF CASH FLOWS
For the Years Ended July 31, 2001, 2000 and 1999

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Cash flows from operating activities:			
Net (loss) income	\$(1,200,559)	\$ 125,709	\$ (837,780)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Amortization of gain on sale	(278,111)	(278,111)	(278,111)
Depreciation and amortization	20,441	52,151	46,532
Discount on sale of long-term receivable	388,447	—	—
Debt forgiveness	(198,000)	—	—
(Increase) decrease in assets:			
Accounts receivable	(1,537,871)	(446,154)	(174,244)
Inventories	110,742	(116,098)	79,642
Prepaid expenses and deposits	45,812	(45,517)	728,199
Deferred charges	860,060	331,542	471,336
Deferred income taxes	—	—	35,419
Other assets	2,702	(13,879)	2,702
Increase (decrease) in liabilities:			
Accounts payable	2,564,897	180,703	(130,672)
Accrued liabilities	39,194	283,598	8,542
Lease payable	22,710	(113,712)	(35,464)
Due to affiliated companies	580,514	162,038	218,490
Net cash flows provided by operating activities	<u>1,420,978</u>	<u>122,270</u>	<u>134,591</u>
Cash flows from investing activities:			
Changes in restricted cash and cash equivalents	(43,331)	7	(528,087)
Disposals of property and equipment	117,789	—	—
Net cash flows provided by (used in) investing activities	<u>74,458</u>	<u>7</u>	<u>(528,087)</u>
Cash flows from financing activities:			
Repayments of long-term obligations	(135,000)	(152,113)	(23,576)
Repayments on capital leases	(8,477)	(5,523)	—
Net cash flows used in financing activities	<u>(143,477)</u>	<u>(157,636)</u>	<u>(23,576)</u>
Net increase (decrease) in cash and cash equivalents	1,351,959	(35,359)	(417,072)
Cash and cash equivalents at beginning of year	1,133,907	1,169,266	1,586,338
Cash and cash equivalents at end of year	<u>\$ 2,485,866</u>	<u>\$1,133,907</u>	<u>\$1,169,266</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	<u>\$ 158,117</u>	<u>\$ 138,654</u>	<u>\$ 406,348</u>
Income taxes	<u>\$ 3,200</u>	<u>\$ 3,665</u>	<u>\$ 3,200</u>
Supplemental disclosure of noncash investing and financing activities:			
Purchase of property and equipment on capital lease	<u>\$ —</u>	<u>\$ 45,602</u>	<u>\$ —</u>

The accompanying notes are an integral part of the financial statements.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Business

Dynamis, Inc. (“Dynamis”) is a wholly-owned subsidiary of DAF-California, Inc. (“DAF”). Dynamis operates a natural gas fired cogeneration facility and a thermal host-user, which manufactures hydraulic mulch used in landscaping. The facility is located in Sanger, California and has a July 31 fiscal year end. The cogeneration facility generates electricity for sale to Pacific Gas & Electric Company (“PG&E”) pursuant to a long-term power purchase agreement. The steam generated from the cogeneration process is sold/transferred to the adjacent thermal host user.

Basis of Accounting

The Company’s policy is to use the accrual method of accounting and to prepare and present financial statements in accordance with accounting principles generally accepted in the United States of America. All figures are presented in US dollars. These accounting principles do not differ in any material respects from accounting principles generally accepted in Canada.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Inventory

Inventory consists of hydraulic mulch in various stages of production, and is stated at the lower of cost (determined on a first-in, first-out basis) or market.

Property and Equipment

Property and equipment are stated at cost. The double-declining balance method of depreciation is followed for substantially all assets for financial reporting and tax purposes. There is approximately \$260,000 in fully depreciated land improvements and \$24,800 in fully depreciated tools and equipment that are still in use as of July 31, 2001 and 2000.

Expenditures for maintenance, repairs and minor renewals are charged to operations as incurred. Expenditures for major maintenance shutdowns are capitalized and charged to operations on a straight-line basis over the period benefited by the major maintenance shutdown (usually three years).

Property and equipment consisted of the following as of July 31:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Land	\$ 50,000	\$ 167,788	\$ 167,788
Land improvement	333,744	333,744	333,744
Furniture and equipment	70,401	70,401	24,799
	<u>454,145</u>	<u>571,933</u>	<u>526,331</u>
Less accumulated depreciation	<u>(329,865)</u>	<u>(309,423)</u>	<u>(257,272)</u>
Property and equipment	<u>\$ 124,280</u>	<u>\$ 262,510</u>	<u>\$ 269,059</u>

Reclassification

Certain prior year amounts have been reclassified to conform to the current year’s presentation.

Deferred Gain

The Company amortizes its deferred gain on the sale of its cogeneration facility under a sale-leaseback over the term of the lease on a straight-line basis.

Major Customer

All of the Company’s electrical generation sales are to the local California Public Utility Company, Pacific Gas & Electric Company, under a 30-year standard offer power purchase agreement (“PPA”) which expires in the year 2022.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under the asset and liability method, deferred income taxes are recognized for the tax consequences of “temporary differences” by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

NOTE 2 — RESTRICTED CASH AND CASH EQUIVALENTS

Under terms of the sale-leaseback agreement entered into with Chemical Bank (Note 7), certain funds are restricted which are designed for the fulfillment of various terms, operating cash requirements and construction requirements of the sale-leaseback agreement. These funds are controlled by banks under the terms of a trust agreement entered into as a part of the sale-leaseback transaction.

NOTE 3 — INVENTORIES

Inventories consist of the following at July 31:

	2001	2000	1999
Raw materials	\$ 79,822	\$113,979	\$152,236
Finished goods	82,802	159,387	5,032
	<u>\$162,624</u>	<u>\$273,366</u>	<u>\$157,268</u>

Certain amounts of the Company's raw materials are obtained from a limited number of suppliers.

NOTE 4 — LONG TERM RECEIVABLES AND PAYABLES

On December 21, 1990, the Company entered into Amendment 4 of its Standard Offer 2 Power Purchase Agreement with PG&E to supply firm capacity and energy for a period of 30 years commencing on May 1, 1991 through April 30, 2022. In 1997, California instituted deregulation of the electricity industry. Under deregulation, PG&E was forced to divest itself of much of its internal generation capacity and purchase, from the Power Exchange (PX), any shortfall between retail consumer demand and what it could produce through its' remaining internal generation capabilities or procure through existing power purchase agreements from Qualified Facilities (QF's) or Small Power Producers. During the fourth quarter of 2000, the California energy market experienced dramatic increases in the cost of natural gas due to shortages in supply and transmission constraints. As a result, the cost to PG&E of purchasing electricity on the wholesale market from the PX increased dramatically without a rate increase approved by the California Public Utility Commission (CPUC) that PG&E could charge back to its' retail customers.

In January 2001, PG&E notified the Company that it did not have sufficient funds to pay for firm capacity and energy payments in accordance with the PPA. PG&E paid 15% of amounts owed to the Company and proposed to pay the balance of the claim plus interest at a later date. On April 6, 2001, citing failure of the CPUC to permit PG&E recovery of its' cost to procure the wholesale electricity purchases from the PX, PG&E filed for Chapter 11 Federal Bankruptcy Court Protection.

During April 2001, PG&E filed for protection under Chapter 11 of the U.S. Bankruptcy Code. Under the bankruptcy court protection, PG&E began to make full payments on a going forward basis from the petition date of April 6, 2001 for firm capacity and energy delivered to it from the Company. On July 14, 2001, the Company entered into Amendment 5 of the PPA and on July 27, 2001, the United States Bankruptcy Court ordered the assumption of the PPA by PG&E. Under the terms of Amendment 5, (1) the PPA will continue through its' original term until April 30, 2022, (2) PG&E will pay the Company a five-year average fixed energy price of 5.37 cents/kwh from September 1, 2001 through July 15, 2006 in accordance with CPUC issued Decision No. 01-06-015, (3) PG&E and the Bankruptcy Court recognize all pre-petition payables due the Company, totalling \$3,884,475 plus accrued interest, as an

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 4 — LONG TERM RECEIVABLES AND PAYABLES (Continued)

administrative expense with administrative privilege. The Company's administrative claim will be payable upon approval of the PG&E reorganization plan by the creditors and the Bankruptcy Court. If however, the approval of the Reorganization plan has not occurred by July 15, 2003, PG&E will pay the Company 2% of the total cure amount monthly until July 15, 2005, at which time all remaining cure amounts will be paid in full.

Consequently, the Company considers the amount receivable from PG&E of \$3,884,475 as a long term receivable, as well as the amount of \$2,637,564 (representing the gas amount to be paid to Natural Gas against the PG&E receivable) as a long term payable. (See Note 14 — Subsequent Events)

On March 16, 2001, the Company's natural gas supplier, Dynegy, entered into Payment Arrangements for amounts owed by the Company totalling approximately \$2,498,800 for natural gas purchases in December 2000 and January 2001. Under the Payment Arrangements, the Company will make progress payments for 85% of amounts it receives from PG&E for December 2000 or January 2001 power deliveries up to the total of amounts due Dynegy with accrued interest. (See Note 14 — Subsequent Events)

NOTE 5 — DEFERRED CHARGES

Deferred charges consist principally of the excess of actual lease payments made for the sale-leaseback, described in Note 7, over the straight line lease expense.

NOTE 6 — CONCENTRATION OF CREDIT RISK

The Company has concentrated its credit risk for cash by maintaining deposits in two banks. The maximum losses that could have resulted from that risk for the excess of the deposit liabilities reported by the bank over the amounts covered by federal insurance was approximately \$2,287,300, \$981,300 and \$908,400 at July 31, 2001, 2000 and 1999, respectively. The Company has not experienced any losses in such accounts and management believes it places its cash on deposit with financial institutions which are financially stable. Other significant concentrations of credit risk are significant receivables that are due from PG&E.

NOTE 7 — DEFERRED GAIN ON SALE

On December 15, 1990, the Company entered into a sale-leaseback of a self constructed natural gas fired cogeneration facility with Chase Manhattan Bank and Trust and leased the facility back for a period of twenty years at an average annual rental of \$6,290,000 per year. Chase Manhattan Bank and Trust simultaneously entered into a Trust Participant Agreement with Viacom, formerly Westinghouse Credit Corporation, whereby ownership was transferred.

The Company invested approximately \$56,400,000 for construction of the plant, including \$2,220,294 of interest, which had been capitalized to the cost of the plant. The Company sold the plant in 1991 to Chase Manhattan Bank and Trust, formerly Chemical Bank, for \$67,400,000 resulting in a gain of approximately \$6,110,621 after financing and closing costs.

The resulting gain was deferred under sale-leaseback accounting and is being amortized on a straight-line basis over the term of the lease.

NOTE 8 — LONG TERM OBLIGATIONS

Long-term obligations consist of the following at July 31:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Mello-Roos obligations	\$1,965,000	\$2,100,000	\$2,225,000
Subordinated debt	254,626	254,626	254,626
Obligations to the City of Sanger	125,469	125,469	152,582
	<u>2,345,095</u>	<u>2,480,095</u>	<u>2,632,208</u>
Less: current portion	407,912	395,806	406,736
	<u>\$1,937,183</u>	<u>\$2,084,289</u>	<u>\$2,225,469</u>

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 8 — LONG TERM OBLIGATIONS (Continued)

Aggregate payments for these obligations are as follows:

Year ending July 31:	
2002	\$ 407,912
2003	153,173
2004	159,398
2005	170,808
2006	177,429
Thereafter	<u>1,276,375</u>
	<u>\$2,345,095</u>

The Company entered into an agreement with the City of Sanger to finance public improvements to property adjacent to or within the plant facility, under the provisions of the Mello-Roos Community Facilities Act of 1982. Total proceeds of the financing were \$2,410,000. On June 1, 1998, the original bonds were restructured. Total proceeds of the new bond financing were \$2,225,000.

The Company entered into a subordinated debt agreement (“Note”) with Kendall Capital, for \$254,626 for fees owed for services rendered relating to the sale-leaseback transaction. Interest accrues at a prime rate, 6.75% and 9.5% as of July 31, 2001 and 2000, respectively, plus 4% and is payable quarterly. Principal payments are dependent on the operating income of the energy division of the Company, but will not be greater than \$18,188 per payment period. Principal payments are due semi-annually. Since the inception of this Note no principal or interest payments have been made. Management and its legal counsel are of the opinion that payments under the Note are only due from the excess cash flow derived from the Company, as described in the Note. Since the inception of the Note, no excess cashflow has been generated and management is of the opinion that excess cashflow, as described in the Note, is unlikely to be generated in the future under the current financing structure.

The Company entered into an agreement with the City of Sanger for payment of certain fees payable in various amounts over the next twenty years as a condition of obtaining operating permits. This obligation has been treated as a cost of construction of the power plant and discounted at the Company’s cost of funds, which was 15% at the time the agreement was entered into.

NOTE 9 — CAPITAL LEASE OBLIGATION

Capital lease obligation consists of the following as of July 31:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Capital lease obligation with interest and principal payable in monthly instalments of approximately \$991. The capital lease obligation is secured by the related equipment. The capital lease obligation is due in December 2004.	\$31,602	\$40,079	\$ —
Less: Current portion	<u>(8,891)</u>	<u>(7,878)</u>	<u>—</u>
Capital lease obligation, long-term	<u>\$22,711</u>	<u>\$32,201</u>	<u>\$ —</u>

Aggregate maturities of capital lease obligations as of July 31, 2001, are as follows:

	<u>Amount</u>
Year Ended July 31,	
2002	\$11,898
2003	11,898
2004	11,898
2005	<u>2,974</u>
Total minimum lease payments	38,668
Less: Amount representing interest	<u>(7,066)</u>
	<u>\$31,602</u>

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 9 — CAPITAL LEASE OBLIGATION (Continued)

Capitalized lease included in property and equipment amounted to approximately \$45,600 and \$45,600 before accumulated amortization of \$20,065 and \$6,840 as of July 31, 2001 and 2000, respectively. Included in depreciation and amortization expense is amortization of capital lease assets in the amounts of approximately \$13,225 and \$6,840 for the years ended July 31, 2001 and 2000, respectively.

NOTE 10 — TRANSACTION WITH AFFILIATES

Groupe Dynamis, a Canadian company related to the Company's shareholder, charges certain costs and expenses, primarily general and administrative, to the Company. Total costs and expenses charged to the Company totalled approximately \$96,000 for each of the years ended July 31, 2001, 2000 and 1999, respectively.

NOTE 11 — COMMITMENTS AND CONTINGENCIES

The Company conducts a substantial portion of its operations utilizing leased facilities and equipment consisting of the electrical cogeneration power plant, administrative office space, office furniture and computer equipment, and vehicles. Some of the operating leases provide that the Company pays taxes, maintenance, insurance and other occupancy expense applicable to leased premises. Generally, the leases provide for renewal for various periods at stipulated rates.

During the year ended July 31, 1997, the facility and equipment lease agreement was amended, to provide among other things, for the payment of an unscheduled lease payment totalling \$7,700,000 and for the conversion of the animal feed production facility into a hydro-mulch facility. For future years, the Company will deduct the \$7,700,000 lease prepayment over the remaining life of the lease term for both federal and California income tax purposes. In addition, the agreement provides for the payment of future additional unscheduled rent payments depending upon the accumulation of excess funds. Such unscheduled lease payments allow the lessor the right to reprice future scheduled lease payments to maintain original rates of return under the lease. During the years ended July 31, 2001, 2000 and 1999, scheduled rent payments were repriced based on excess rents paid.

Minimum lease commitments are as follows:

Year ending July 31:	
2002	\$ 6,071,337
2003	6,132,065
2004	6,128,143
2005	6,120,141
2006	6,101,536
Thereafter	<u>34,073,215</u>
Future minimum lease payments	<u>\$64,626,437</u>

Total rent expense for the years ended July 31, 2001, 2000 and 1999 was \$6,405,131, \$6,370,562 and \$6,185,949, respectively. Cash rent payments for the years ended July 31, 2001, 2000 and 1999 totalled \$5,801,809, \$5,609,958 and \$5,610,829, respectively.

During 1998, the Company entered into a Gas Transmission Service Agreement — Transportation Service contract which requires the Company to pay approximately \$8,500 per month for transportation of natural gas to the Company's facility. This agreement remains in force until December 31, 2002.

The Company is required to maintain its Qualified Facility ("QF") status as imposed by regulatory and contractual requirements. If the QF status is not maintained, certain penalties may be imposed and/or contractual agreements modified. The Company believes that it was in compliance with the requirements to maintain its QF status during the fiscal years ended July 31, 2001, 2000 and 1999.

DynaFibers, Inc. (a wholly owned subsidiary of DAF-California, Inc.), an inactive corporation, assigned its rights and obligations under a hydro-mulch product sales agreement to Dynamis.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 12 — INCOME TAXES

Deferred income taxes reflect the net tax effects of the temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. The tax effect of temporary differences consisted of the following as of July 31:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Deferred tax assets:			
Net operating loss carryforwards	\$ 2,205,000	\$ 1,316,000	\$ 1,500,000
Deferred gain on plant sale	1,117,000	1,228,000	1,300,000
Differences in lease expense recognition	1,088,000	1,119,000	1,100,000
Other	192,000	209,000	280,000
Gross deferred tax assets	<u>4,602,000</u>	<u>3,872,000</u>	<u>4,180,000</u>
Deferred tax liabilities:			
Property and equipment	(10,000)	(10,000)	—
Less: Valuation allowance	<u>(2,492,000)</u>	<u>(1,762,000)</u>	<u>(2,080,000)</u>
Net deferred tax assets	<u>\$ 2,100,000</u>	<u>\$ 2,100,000</u>	<u>\$ 2,100,000</u>

Realization of deferred tax assets is dependant upon sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income. As the achievement of required future taxable income is uncertain, the Company recorded a valuation allowance. The valuation allowance increased by \$730,000 and decreased by \$318,000 and \$547,000 from 2000, 1999 and 1998, respectively.

As of July 31, 2001, the Company has net operating loss carryforwards for both federal and state income tax purposes. Federal and state net operating loss carryforwards totalling approximately \$5,742,000 and \$2,339,000, begin to expire in 2011 and 2002, respectively.

The principal types of temporary difference, which are measured at the current tax rates, are deferred gain on the sale of plant and equipment, deferred rent, the lease prepayment, amortization and net operating loss carryforwards.

The provision for income taxes is as follows as of July 31:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Current	\$(3,200)	\$(3,665)	\$ (3,200)
Deferred-non-current	—	—	(35,419)
Total income tax expense	<u>\$(3,200)</u>	<u>\$(3,665)</u>	<u>\$(38,619)</u>

NOTE 13 — EMPLOYEE BENEFIT PLAN

The Company has a defined contribution 401(k) tax saving plan for all employees. The Company's contribution expense to the 401(k) plan for the years ended July 31, 2001, 2000 and 1999 was approximately \$30,500, \$25,000 and \$21,000, respectively. The plan is available to full-time employees after a five-month vesting period. The maximum contribution percentage per employee is 15%. The Company will match up to 4% of the employee's salary.

NOTE 14 — SUBSEQUENT EVENTS

Prior to July 31, 2001, the Company began exploring the sale of its long term receivable from PG&E described in Note 4. On November 21, 2001, the Company entered into an agreement with an unrelated third party whereby the third party agreed to pay Dynamis \$3,496,028 in exchange for the Company's right to receive \$3,884,475 from PG&E described in Note 4. In addition, the third party is entitled to receive any interest or additional payments made on the above receivable as a result of the Reorganization Plan described in Note 4. On December 7, 2001, a Notice of Transfer of Administrative claim was filed in the United States Bankruptcy Court. The transfer of funds for this agreement took place on December 21, 2001. This discount has been recorded during the fiscal year ended July 31, 2001.

DYNAMIS, INC.
NOTES TO THE FINANCIAL STATEMENTS (Continued)
For the Years Ended July 31, 2001, 2000 and 1999

NOTE 14 — SUBSEQUENT EVENTS (Continued)

On November 21, 2001, the Company entered into an agreement with Dynegy whereby Dynegy agreed to accept \$2,300,000 in full payment of the outstanding obligation owed by the Company totalling \$2,498,000. On December 26, 2001, the Company transferred funds in full settlement of this obligation. The Company recorded the gain associated with this debt forgiveness upon the payment of the above amount to Dynegy.

On January 16, 2002, the Company signed a non binding letter of intent with an unrelated third party for the sale of all of the assets of the Company.

CERTIFICATE OF ALGONQUIN POWER INCOME FUND

Dated: September 30, 2002

This short form prospectus, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by the securities legislation of all of the provinces of Canada. For the purpose of the Province of Québec, this simplified prospectus, as supplemented by the permanent information record, contains no misrepresentation that is likely to affect the value or the market price of the securities to be distributed.

ALGONQUIN POWER INCOME FUND
By: Algonquin Power Management Inc.

By: (Signed) CHRIS K. JARRATT
Chief Executive Officer and Director

By: (Signed) PETER KAMPIAN
Chief Financial Officer

By: (Signed) IAN E. ROBERTSON
Director

By: (Signed) DAVID C. KERR
Director

By: (Signed) JOHN M.H. HUXLEY
Director

CERTIFICATE OF THE UNDERWRITERS

Dated: September 30, 2002

To the best of our knowledge, information and belief, this short form prospectus, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by the securities legislation of all of the provinces of Canada. For the purpose of the Province of Québec, to our knowledge, this simplified prospectus, as supplemented by the permanent information record, contains no misrepresentation that is likely to affect the value or the market price of the securities to be distributed.

BMO NESBITT BURNS INC.

NATIONAL BANK FINANCIAL INC.

By: (Signed) KENNETH MANGET

By: (Signed) WILLIAM M. CROSSLAND

CIBC WORLD MARKETS INC.

TD SECURITIES INC.

By: (Signed) DAVID H. WILLIAMS

By: (Signed) ROB WRIGHT

RBC DOMINION SECURITIES INC.

SCOTIA CAPITAL INC.

By: (Signed) ALINA M. OSORIO

By: (Signed) J. PAUL ROLLINSON

RAYMOND JAMES LTD

By: (Signed) JAMES COULTER

