# PRIMARY ENERGY RECYCLING CORPORATION

**Consolidated Financial Statements**
**(In US Dollars)**

**Period from August 24, 2005 to December 31, 2005**

## TABLE OF CONTENTS


| | Page No. |
|---|---|
| Auditors' Report | 3 |
| Financial Statements | |
| Consolidated Balance Sheet as of December 31, 2005 | 4 |
| Consolidated Statement of Operations and Shareholders' Deficit for the Period from August 24, 2005 to December 31, 2005 | 5 |
| Consolidated Statement of Cash Flows for the Period from August 24, 2005 to December 31, 2005 | 6 |
| Notes to Consolidated Financial Statements | 7 – 21 |

## AUDITORS' REPORT

To the Board of Directors of
PRIMARY ENERGY RECYCLING CORPORATION

We have audited the consolidated balance sheet of Primary Energy Recycling Corporation (the "Company") as at December 31, 2005 and the consolidated statements of operations and accumulated deficit and cash flows for the period from August 24, 2005 to December 31, 2005. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and the results of its operations and its cash flows for the period from August 24, 2005 to December 31, 2005 in accordance with Canadian generally accepted accounting principles.

Chicago, Illinois USA
March 29, 2006 (Signed) "PricewaterhouseCoopers LLP"

# PRIMARY ENERGY RECYCLING CORPORATION
## CONSOLIDATED BALANCE SHEET
(In thousands of U.S. dollars)

| ASSETS | | December 31, 2005 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ | 12,090 |
| Accounts receivable | | 14,847 |
| Spare parts inventory | | 1,033 |
| Current future tax asset (Note 12) | | 1,363 |
| Other current assets | | 802 |
| **Total current assets** | | 30,135 |
| Non-current assets: | | |
| Property, plant and equipment, net (Note 6) | | 260,241 |
| Intangible assets, net (Note 5) | | 209,711 |
| Foreign currency exchange contracts (Note 14) | | 3,492 |
| Interest rate swap contract (Note 14) | | 639 |
| Deferred finance fees, net | | 8,019 |
| Other non-current assets | | 247 |
| **Total assets** | $ | 512,484 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ | 162 |
| Due to affiliates (Note 15) | | 376 |
| Accrued property taxes | | 5,255 |
| Accrued interest payable | | 1,888 |
| Distributions payable | | 2,508 |
| Accrued expenses | | 3,254 |
| **Total current liabilities** | | 13,443 |
| Long term debt (Note 7) | | 217,340 |
| Future tax liability (Note 12) | | 59,275 |
| Asset retirement obligation | | 2,749 |
| **Total liabilities** | | 292,807 |
| Commitments and contingencies (Note 8) | | |
| Non-controlling preferred interests (Note 9) | | 13,225 |
| Non-controlling common interests (Note 9) | | 36,418 |
| Shareholders' equity: | | |
| Common stock (Note 10) | | 178,571 |
| Shareholders' deficit | | (8,537) |
| **Total shareholders' equity** | | 170,034 |
| **Total liabilities, non-controlling interests and shareholders' equity** | $ | 512,484 |

The accompanying notes are an integral part of these consolidated financial statements.

**Primary Energy Recycling Corporation**
**CONSOLIDATED STATEMENT OF OPERATIONS AND SHAREHOLDERS' DEFICIT**
(In thousands of U.S. dollars, except share and per share amounts)

| | | Period from August 24, 2005 to December 31, 2005 |
|---|---|---|
| **Revenue:** | | |
| Capacity | $ | 12,800 |
| Energy Service | | 19,599 |
| | | 32,399 |
| **Expenses:** | | |
| Operations and maintenance | | 7,549 |
| General and administrative | | 5,744 |
| Depreciation and amortization | | 14,405 |
| **Operating income** | | 4,701 |
| **Other Income (Expense):** | | |
| Interest income (expense), net | | (7,211) |
| Unrealized gain on derivative hedge contracts (Note 14) | | 4,612 |
| (Loss) on foreign currency translation | | (2,310) |
| **Loss before income taxes** | | (208) |
| Income tax expense (Note 12) | | (1,925) |
| **Loss before non-controlling interest** | | (2,133) |
| Non-controlling interest in class B Preferred | | (537) |
| Non-controlling interest in class B Common | | 1,706 |
| **Net Loss** | $ | (964) |
| Shareholders' deficit - beginning of period | | - |
| Distributions | | (7,573) |
| Shareholders' deficit - end of period | $ | (8,537) |
| **Weighted average number of shares outstanding** | | 30,326,923 |
| **Basic and Diluted net loss per share** (Note 16) | $ | (0.03) |

The accompanying notes are an integral part of these consolidated financial statements.

# Primary Energy Recycling Corporation
## CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands of U.S. dollars, unless specified)

| | | Period from August 24, 2005 to December 31, 2005 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net loss | $ | (964) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | | 14,405 |
| Unrealized loss on foreign currency translation | | 2,310 |
| Unrealized gain on foreign currency exhange contracts and interest rate swaps | | (4,612) |
| Amortization of deferred finance costs | | 439 |
| Future income taxes | | 1,925 |
| Accretion of asset retirement obligations | | 67 |
| Changes in operating assets and liabilities, net of assets and liabilities acquired: | | |
| Accounts receivable | | (4,600) |
| Other assets | | (476) |
| Accounts payable | | (84) |
| Accrued property tax | | 531 |
| Accrued interest payable | | 1,888 |
| Accrued expenses | | (185) |
| Non-controlling interests | | (1,706) |
| Net cash provided by operating activities | | 8,938 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Business acquisitions, net of cash acquired of $5,482 | | (157,911) |
| Purchase of Class B non-controlling interest shares upon exercise of over-allotment option | | (20,237) |
| Net cash (used in) investing activities | | (178,148) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Net proceeds from sale of initial public offering common shares | | 163,393 |
| Net proceeds from sale of common shares upon exercise of over-allotment option | | 15,178 |
| Debt issuance | | 209,690 |
| Net proceeds from sale of subordinated notes upon exercise of over-allotment option | | 5,339 |
| Payments on predecessor long-term debt and debt prepayment penalties | | (197,603) |
| Payment of deferred financing fees | | (8,458) |
| Increase in amounts owed to affiliates | | 376 |
| Distributions | | (6,615) |
| Net cash provided by financing activities | | 181,300 |
| Net increase in cash | | 12,090 |
| | | |
| Cash - beginning of period | | - |
| Cash - end of period | $ | 12,090 |
| | | |
| **Supplemental disclosure of cash flow information:** | | |
| Cash paid during the period for interest | $ | 5,192 |

The accompanying notes are an integral part of these consolidated financial statements.

## 1. Description of Business

Primary Energy Recycling Corporation (the "Company") was incorporated on June 10, 2005 under the laws of the Province of Ontario and continued under the laws of British Columbia. For the period from June 10, 2005 to August 23, 2005, the Company was inactive and, accordingly, a consolidated statement of operations and statement of cash flows for this period have not been presented. The Company initiated business activity on August 24, 2005 upon completion of an initial public offering (the "Offering") of 28.5 million enhanced income securities ("EISs"). Each EIS is comprised of one common share of the Company ("Common Share") and Cdn$2.50 of aggregate principal amount of 11.75% subordinated notes of the Company ("Subordinated Notes"). On September 27, 2005, the underwriters of the Offering partially exercised their over-allotment option (the "Over-Allotment Option") and purchased an additional 2.5 million EISs. In conjunction with the Offering, the Company acquired a majority interest in Primary Energy Recycling Holdings, LLC ("PERH"). The non-controlling interests of PERH is held by Primary Energy Holdings, LLC ("PEH") a wholly-owned subsidiary of Primary Energy Ventures, LLC (the "Manager"). PERH, headquartered in Oak Brook, Illinois, indirectly owns and operates four recycled energy projects and a 50% interest in a pulverized coal facility all located in the United States (collectively, the "Projects"). The Projects have a combined electrical generating capacity of 283 megawatts and a combined steam generating capacity of 1,851 Mlbs/hour. PERH creates value for its customers by capturing and recycling waste energy from industrial processes and converting it into reliable and economical electricity and thermal energy for its customers' use. For additional information with respect to the business, please see the Company's public filings including its Annual Information Form dated March 30, 2006 available on SEDAR at www.sedar.com.

These consolidated financial statements present the results of operations of the Company from the close of the Offering on August 24, 2005 to December 31, 2005.

## 2. Basis of Presentation

The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") and include the consolidated accounts of the Company's subsidiaries. The consolidated financial statements for the period from August 24, 2005 to December 31, 2005 include all normal recurring adjustments which management considers necessary for fair presentation. Significant inter-company accounts and transactions have been eliminated in consolidation.

## 3. Summary of Significant Accounting Policies

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses in the financial statements. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable. If actual amounts are ultimately different from these estimates, the revisions are included in the Company's results of operations for the period in which the actual amounts become known. The significant accounting policies are described below:

***Cash and Cash Equivalents***
Cash and cash equivalents include all cash balances and highly liquid investments with an original maturity of three months or less at the date of purchase.

***Spare Parts Inventory***
The Company maintains a certain level of spare parts inventory at its facilities. The parts on-hand are stated at lower of cost or market value and are included in the current assets of the Company. The Company expenses parts as they are used.

***Property, Plant and Equipment***
Property, plant and equipment are accounted for at acquisition cost. The cost for all asset classes is depreciated on a straight-line basis over the estimated useful lives of the assets. Generally, the estimated useful lives are 30 years for buildings, plant and equipment. The estimated useful life of office furniture and equipment is 7 years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the assets. Expenditures for maintenance and repairs are charged to income as incurred. The carrying amount for long-lived assets is reviewed whenever events or changes in circumstances indicate that impairment may have occurred.

***Impairment of Intangible Assets***
It is the Company's policy to value intangible assets at the lower of unamortized cost or fair value. Management reviews the valuation and amortization of intangible assets on a periodic basis, taking into consideration any events or circumstances that might result in diminished fair value. The Company periodically reviews the estimated useful lives of its identifiable intangible assets, taking into consideration any events which might result in diminished fair value or revised useful life.

### *Functional Currency*

The functional currency of the Company is the U.S. dollar and all amounts presented in these financial statements and notes contained herein are presented in U.S. dollars, unless otherwise specified. The Company translates monetary assets and liabilities denominated in foreign currencies, principally its subordinated debt, which is denominated in Canadian dollars, at exchange rates in effect at the balance sheet date. Foreign exchange gains and losses are included in the consolidated statement of operations.

### *Deferred Finance Fees*

The Company capitalizes costs associated with the issuance of debt instruments. These costs are amortized on a straight-line basis over the term of the debt. In connection with the debt issued and credit facilities entered into connection with the Offering in August of 2005 and debt issued in the Offering, the Company paid $8.5 million for financing fees that have been deferred and are being amortized over the term of the underlying credit facilities. For the period of August 24, 2005 through December 31, 2005, the Company has amortized $0.4 million of deferred financing fees.

### *Asset Retirement Obligations*

The fair value of estimated asset retirement obligations is recognized in the consolidated balance sheet when identified and a reasonable estimate of fair value can be made. The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. The asset retirement costs are amortized over the asset's estimated useful life and included in depreciation expense on the consolidated statement of operations and members' deficit. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation in the consolidated statement of operations and members' deficit. Actual expenditures incurred are charged against the accumulated obligation.

### *Revenue Recognition*

The Company operates its facilities under certain tolling and operation and maintenance agreements with its customers. These agreements with customers qualify as operating lease arrangements for accounting purposes under the principles of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3065, "*Leases*" and (EIC-150), "*Determining Whether an Arrangement Contains a Lease*." The Company presents the fixed monthly payments from these contracts as Capacity revenue on its consolidated statement of operations. Substantially all of the Company's buildings and equipment serve as rental property under these operating leases.

Revenue is recorded on the accrual basis and may include estimates for services delivered. Capacity revenue represents the fixed revenue amounts established in the tolling agreements with the Company's customers. Energy Service revenue represents the revenue earned based on measurements of services performed in each period.

The Company provides estimates for doubtful accounts it deems necessary based on the aging category and specific knowledge of the customers ability to pay. No such allowances were recorded at December 31, 2005.

***Accounting for Derivatives***

The Company evaluates derivatives in accordance with Accounting Guideline 13 "Hedging Relationships" ("AcG-13"). For those derivatives that do not qualify for hedge accounting under AcG-13 the derivative instrument is recorded on the balance sheet as either an asset or liability measured at its fair value, with changes in fair value recognized currently in earnings.

***Accounting for Joint Ventures***

Investments in joint ventures are accounted for using the proportional consolidation method.

***Earnings per share***

Basic earnings per share are computed based on the weighted average number of Common Shares outstanding. As of December 31, 2005, there are no potentially dilutive securities issued and outstanding. Accordingly, diluted earnings per share is equivalent to basic earnings per share.

## 4. Acquisition

The Company was formed for the purpose of acquiring an indirect interest in the Projects from PERH. The interests of PERH in the Projects were held by its wholly-owned subsidiary, Primary Energy Operations LLC ("PEO"). The net proceeds from the Offering, after deducting fees and expenses, were Cdn$263.4 million. In addition to the Cdn$71.25 million of Subordinated Notes issued in connection with the Offering, Cdn$18.5 million of separate subordinated notes (not forming part of EISs), (the "Separate Subordinated Notes") were issued. On closing of the Offering, the Company also arranged for a new credit facility (the "Credit Facility") in the aggregate amount of Cdn$180.0 million, of which Cdn$162.3 million was drawn as of the closing of the Offering.

The Company used the proceeds from the Offering, together with net proceeds of Cdn$16.8 million from the sale of the Separate Subordinated Notes, to subscribe for 100% of the Class A preferred and common interests of PERH. PEH owns 100% of the Class B preferred and common interests of PERH.

PERH used Cdn$280.3 million of the proceeds from the subscription for membership interests received from the Company to repay Cdn$204.7 million of outstanding senior indebtedness and make a Cdn$79.3 million capital contribution to PEO. PEO used the Cdn$79.3 million of proceeds from the capital contribution by PERH plus Cdn$162.3 million drawn under the Credit Facility, to make capital contributions to each of North Lake, Ironside, Cokenergy, Portside and Harbor Coal. Each of North Lake, Ironside, Cokenergy and Portside used the proceeds of the capital contributions from PEO to repay outstanding senior indebtedness. Harbor Coal used the proceeds of the capital contribution from PEO to make a capital contribution to PCI Associates, a joint venture (“PCI”), which in turn used such proceeds to repurchase the leased portion of the coal pulverization facility from its lessor. Following the completion of the Offering and prior to exercise of the Over-Allotment Option, the Company owned a 76.5% financial interest in PERH and PEH indirectly owned a 23.5% financial interest in PERH.

The acquisition of PERH has been accounted for using the purchase method of accounting. The net purchase price was $163.4 million. The final allocation of the purchase price to the fair values of the consolidated assets acquired and liabilities assumed at August 24, 2005 is as follows:

| | |
|---|---|
| Current assets less current liabilities | $ 11,551 |
| Property and equipment | 263,975 |
| Contract value and other intangibles | 220,432 |
| Deferred financing fees on acquisition debt | 8,177 |
| Other assets | 751 |
| Long-term debt | (209,690) |
| Asset retirement obligation | (2,682) |
| Future tax liability | (55,984) |
| Non-controlling interests | (73,137) |
| | $ 163,393 |

The Company allocated the purchase price based upon valuations completed by a third party. The fair value of the consolidated assets acquired and liabilities assumed was in excess of the purchase price resulting in negative goodwill which has been allocated to long term assets. Material adjustments to the initial allocation are the result of finalizing the future tax liability with a corresponding adjustment recorded to long term assets.

The Company granted an Over-Allotment Option to purchase up to a total of 4.275 million additional EISs for the purpose of covering over-allotments, if any, and for market stabilization purposes. On September 27, 2005 the Over-Allotment Option was partially exercised to purchase 2.5 million EISs resulting in net proceeds of Cdn$23.7 million. The Company used the net proceeds to

acquire additional Class A preferred and common interests in PERH. PERH in turn used such amounts to acquire, on a pro rata basis, Class B preferred and common interests in PERH. Upon exercise of the Over-Allotment Option, the Company owns 83.2% of PERH and PEH owns a 16.8% financial interest in PERH. The purchase of additional non-controlling interests does not result in any additional purchase accounting.

## 5. Intangible assets

Intangible assets consist of contract rights on leases and nitrogen oxide (NOx) allowances. Contract rights represent the value assigned to existing customer contracts at the date of the acquisition and are amortized on a straight line basis over an average term of eight years. As of August 24, 2005, $219.5 million was assigned to contract rights and amortization was $10.6 million for the 130 day period ended December 31, 2005. NOx allowances expire from 2005 through 2009. As of August 24, 2005, $0.9 million was assigned to the NOx allowances representing fair value. During the 130 day period ended December 31, 2005, NOx allowances of $0.05 million were sold at book value and $0.1 million of amortization was recognized.

| | Cost | Accumulated Amortization | Disposals | Net Book Value |
|---|---|---|---|---|
| Contract Value and other intangibles | $ 220,432 | $ (10,671) | $ (50) | $ 209,711 |

## 6. Property, Plant and Equipment

Property, plant and equipment consist of the following at December 31, 2005 (amounts in thousands):

| | Cost | Accumulated Depreciation | Net Book Value |
|---|---|---|---|
| Buildings…………………………… | $ 22,581 | $ (294) | $ 22,287 |
| Plant Equipment…………………… | 241,394 | (3,440) | 237,954 |
| | $ 263,975 | $ (3,734) | $ 260,241 |

## 7. Long-term Debt

Long term obligations consist of the following:

| | | December 31, 2005 |
|---|---|---|
| Notes payable…………………………… | $ | 135,000 |
| Subordinated debt……………………… | | 82,340 |
| Total ……………………………………… | $ | 217,340 |

| Maturities of long-term debt are as follows: | | |
|---|---|---|
| 2005 ……………………………………… | $ | - |
| 2006 ……………………………………… | | - |
| 2007 ……………………………………… | | - |
| 2008 ……………………………………… | | - |
| 2009 ……………………………………… | | 135,000 |
| Thereafter ………………………………… | | 82,340 |
| Total ……………………………………… | $ | 217,340 |

*Credit Facility*

The Company's Credit Facility is comprised of a $135.0 million four-year term loan facility and a three-year $15.0 million revolving credit facility, of which $0 of the revolving credit facility has been drawn as of December 31, 2005. The Credit Facility bears interest at a rate equal to LIBOR or U.S. Base Rate, plus an applicable margin. The borrower may elect from time to time to convert Eurodollar rate loans to base rate loans or base rate loans to Eurodollar rate loans by providing appropriate notice to the Administrative Agent of the Credit Facility. For the period August 24, 2005 through September 7, 2005, the interest rate was defined using a fixed Prime rate of 6.5% plus 1.75%. For the period September 8, 2005 through December 31, 2005, the interest rate was defined using an average LIBOR rate of 3.9% plus 2.75%. The Credit Facility has a standby fee of 0.5% of the undrawn availability associated with the revolving credit facility. The Credit Facility requires the Company to meet certain financial covenants that among other things, requires the Company to maintain certain defined leverage and coverage ratios. The Credit Facility is collateralized by the Company's interests in, and the assets of, all subsidiaries and Projects. The Company has the ability to prepay the outstanding borrowings at anytime in whole or in part without penalty.

*Subordinated and Separate Subordinated Notes*

The Company has issued Subordinated Notes (forming part of EISs) of US$59.3 million or Cdn$71.25 million (as denominated in Canadian dollars using an exchange rate of Cdn$1.20235 per US$1.00. Upon exercise of the Over-Allotment Option, an additional $5.3 million or Cdn $6.3 million (as denominated in Canadian dollars using an exchange rate of Cdn $1.17050 per US$1.00) of

Subordinated Notes were also issued. The Subordinated Notes have a stated annual interest rate of 11.75% and a term of 12 years. In connection with the Offering, the Company also issued the equivalent of US$15.4 million or Cdn$18.5 million (denominated in Canadian dollars using an exchange rate of Cdn$1.20235 per US$1.00) of Separate Subordinated Notes with a stated annual interest rate of 11.75% and a term of 12 years. For the period ended December 31, 2005, the Company recorded a loss on foreign currency translation of $2.3 million related to these notes denominated in Canadian dollars. Amounts payable under these notes in U.S. dollars at December 31, 2005, have been adjusted to reflect the change in foreign exchange rates. The Subordinated and Separate Subordinated Notes are collateralized by unsecured guarantees of PERC's subsidiaries.

As of December 31, 2005, the Company is in compliance with all debt covenant requirements.

## 8. Commitments and Contingencies

### *Lease Revenue*

The Company's operations include delivery of power obtained through its generation capacity and sold under long term power purchase agreements. These agreements contain firm power purchase commitments related to power generation capability of the specific facilities and are deemed to be operating lease arrangements for accounting purposes. The agreements contain certain tolling provisions that provide for fixed monthly payments to be paid to the Company that are recorded as revenue.

As of December 31, 2005, the Company's future revenue from operating leases is as follows:

| Year ending: | |
|---|---|
| 2006 | $ 39,333 |
| 2007 | $ 39,364 |
| 2008 | $ 39,397 |
| 2009 | $ 39,430 |
| 2010 and thereafter | $ 174,559 |
| Total | $ 332,083 |

### *Environmental Matters*

The Company's operations are subject to a number of federal, state and local laws and regulations relating to the protection of the environment and the safety and health of personnel and the public. Some of the Company's operations require environmental permits and controls to prevent and reduce air and water

pollution, and these permits are subject to modification, renewal and revocation by issuing authorities. These requirements relate to a broad range of activities, including:

- Discharge of pollutants into the air, water and soil
- Identification, generation, storage, handling, transportation, disposal, record keeping, labeling and reporting of, and the emergency response in connection with, hazardous and toxic materials and wastes including asbestos
- Safety and health standards, practices and procedures that apply to the workplace and the operation of facilities

The State of Indiana, where the Company's Projects are located, has initiated the process of implementing two significant federal air quality regulations, the Clean Air Interstate Rule (CAIR) and the Clean Air Mercury Rule (CAMR). These rules are designed to greatly reduce emissions of nitrogen oxides (NOx), sulfur dioxide (SO2) and mercury (Hg) into the environment and are focused on obtaining these reductions from the electricity industry. The State of Indiana has determined that none of the PERC projects qualify as Electric Generating Units and as such, has indicated that the facilities will not likely face any additional requirements associated with the implementation of these federal rules.

The Company's facilities are subject to the Industrial Boiler Maximum Achievable Control Technology (MACT) standards and the Stationary Gas Turbine MACT where the Company has boilers or combustion turbines associated with its operations. In the first phase of compliance with the MACT, the Company was required to submit a notice of coverage to the appropriate state and federal environmental officials. At this time, current controls are deemed sufficient to meet required standards and the Company does not anticipate any additional compliance requirements.

## 9. Non-controlling interests

Non-controlling interests at December 31, 2005 represents the Class B preferred and common shares of PERH retained by the original investors in PERH following the closing of the Offering and the exercise of the Over-Allotment Option. The Class B preferred and common shares represent a 16.8% financial interest in PERH at December 31, 2005. Each Class B common is entitled to receive pro rata distributions as and when declared by the board of managers after payment in full of Class A preferred return and Class B preferred return.

## 10. Common stock

The Company issued 28.5 million EISs for cash proceeds of $237.0 million on closing of the Offering on August 24, 2005. An additional 2.5 million EISs were issued on the closing of the Over-Allotment Option on September 27, 2005 generating additional proceeds of $21.4 million. Each EIS was issued for Cdn$10. Each EIS consists of one Common Share and Cdn$2.50 of aggregate principal amount of 11.75% Subordinated Notes (Note 7). Net proceeds of $178.6 million were allocated to Common Shares. Certain expenses of the Offering were specifically allocated and shared expenses were allocated based on the relative fair value of the Common Shares and the Subordinated Notes.

## 11. Reconciliation to US Generally Accepted Accounting Principles

These consolidated statements have been prepared in accordance with Canadian GAAP, which in most respects conform to accounting principles generally accepted in the United States ("US GAAP"). Significant differences between Canadian GAAP and US GAAP are as follows:

**Net Income**

| | Inception to December 31, 2005 |
|---|---|
| Net loss Canadian GAAP | $ (964) |
| Equity in Partnership Net earnings(i) | 4,124 |
| Revenue(i) | (12,473) |
| Less: | |
| Operations and Maintenance expense(i) | 4,181 |
| General and Administration expense(i) | 358 |
| Depreciation expense(i) | 3,814 |
| Interest income(i) | (4) |
| Net loss US GAAP | $ (964) |

(i) Under Canadian GAAP, PCI is accounted for using the proportional consolidation method. Under US GAAP, the Company's investment in PCI is accounted for using the equity method of accounting.

| **Balance sheet items (ii)** | | **PCI Associates December 31, 2005** |
|---|---|---|
| **Assets** | | |
| *Current Assets:* | | |
| Cash and cash equivalents | $ | 363 |
| Accounts receivable | | 6,638 |
| **Total current assets** | | 7,001 |
| Property and equipment, net | | 38,744 |
| Investment in unconsolidated affiliate | | (103,632) |
| Contract Value | | 59,468 |
| **Total assets** | $ | 1,581 |
| **Liabilities and Equity** | | |
| *Current Liabilities:* | | |
| Accrued property taxes | $ | 1,581 |
| Total current liabilities | | 1,581 |
| Total liabilities and equity | $ | 1,581 |

(ii) Under Canadian GAAP, PCI is accounted for under the proportional consolidation method. Under US GAAP, the Company's investment in PCI is accounted for under the equity method of accounting.

As of December 31, 2005 there were no GAAP differences that would have impacted net equity.

## 12. Income Taxes

Income tax expense (benefit) consists of the following for the year ended December 31, 2005.

| | | |
|---|---|---|
| **Current tax provision:** | | |
| Federal | $ | (2) |
| State | | (1) |
| Total current tax | | (3) |
| | | |
| **Future tax provision:** | | |
| Federal | | 1,666 |
| State | | 262 |
| Total future tax | | 1,928 |
| Total tax expense | $ | 1,925 |

The Company recorded a net future tax liability at the date of acquisition representing the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The net future tax liability at the opening balance sheet date relates solely to the differences in the basis of those assets and liabilities contributed by the non-controlling shareholders, and does not create a liability for EIS holders and will not have an impact on the Company's future cash flows. The future tax liability of $56.0 million as of the opening balance sheet date has been adjusted for purchase accounting purposes based on final appraisals. It will be amortized to non-controlling interests over the life of the

Company's depreciable and amortizable long term assets. Future income tax expense relates to the increase in the future tax liability as reflected on the opening balance sheet date as compared to the future tax liability at the end of the year.

Significant components of the future tax assets and liabilities at December 31, 2005 are as follows:

| | Future Tax Asset / (Liability) |
|---|---|
| Accrued Expenses | $ 708 |
| Foreign Currency Translation | 936 |
| **Current Future Tax Assets** | 1,644 |
| Contract Termination Fee | 19,085 |
| Asset Retirement Obligation | 1,113 |
| Net Operating Loss | 2,009 |
| Valuation Allowance | (2,009) |
| **Long-Term Future Tax Assets** | 20,198 |
| Interest Rate Swap | (281) |
| **Current Future Tax Liability** | (281) |
| Other | (46) |
| Fixed Assets | (17,616) |
| Intangible Assets | (31,947) |
| Investment in PCI | (29,864) |
| **Long-Term Future Tax Liability** | (79,473) |
| **Net Future Tax Liability** | $ (57,912) |

The Company will be required to file tax returns in Canada and the United States. At December 31, 2005, the Company has a U.S. net operating loss carry forward of $4.9 million. The U.S. net operating loss carry forward will expire in 2025. The Company has recorded a full valuation allowance on the net operating loss as it is more likely than not that the future asset will not be realized by the Company.

At December 31, 2005, the Company also has a Canadian net operating loss. The Company has provided a full valuation allowance on the net operating loss as it is more likely than not that the Company will not realize the benefits of the net operating loss.

The principal items which cause the Company's effective tax rate in 2005 to be greater than the Canadian statutory tax rate of 36.12% are the effect of the inclusion of the U.S federal and state income taxes that are greater than the Canadian statutory tax rate and the valuation allowance on the net operating loss are as follows:

| | |
|---|---|
| Income tax Expense at Canadian Statutory Rate: | $ (75) |
| Additional tax from operations in countries with different income tax rates | (9) |
| Valuation Allowance | 2,009 |
| Total Tax Expense | $ 1,925 |

## 13. Asset Retirement Obligation

The Company accounts for its obligations associated with retirement of assets in accordance with the CICA Handbook Section 3110 "*Asset Retirement Obligations.*" Section 3110 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes the cost, thereby increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, a gain or loss is recorded. Certain of the Company's subsidiaries have contractual obligations to remove all buildings and equipment associated with the ground leases related to their facilities. The Company estimated these liabilities based upon an independent valuation. The total undiscounted cash flows required to satisfy the legal obligations are estimated to be $15.6 million, paid over the course of five years between 2025 to 2029. These amounts were discounted by the Company's credit-adjusted risk-free borrowing rate of 7.32%. For the period ended December 31, 2005, the Company recognized accretion expense of $67 and depreciation expense of $33. As of December 31, 2005, the balance of the asset retirement obligation liability was $2.7 million and the balance of the related asset was $2.3 million.

## 14. Derivative Instruments and Hedging Activities

The Company utilizes certain derivative instruments to enhance its ability to manage risk relating to cash flow and interest rate exposure. Derivative instruments are entered into for periods consistent with the related underlying exposures and are not entered into for speculative purposes.

*Foreign Currency Exchange Contracts*
The Company has entered into foreign currency exchange forward contracts (the "Forward Contracts") to exchange U.S. dollars for Canadian dollars. The Canadian dollars will be used to fund interest and cash distributions to EIS holders and interest distributions to the separate subordinate note holders. The contracts are for a series of sixty monthly payment dates through September 2010. At December 31, 2005, fifty seven contracts remain open. Each month, the Company sells a fixed amount of U.S. dollars for a fixed amount of Canadian dollars at a rate of C$1.1712 to U.S. $1.00 for distributions to EIS holders and the non-controlling interest. The forward contracts applicable to distributions for the Separate Subordinated Notes have an exchange rate of Cdn $1.1713 to US $1.00. The Company was not required to deposit any collateral with regard to these contracts. The Forward Contracts do not qualify as a cash flow hedge for accounting purposes, and the change in the fair value is reflected in income. Fair

value of the Forward Contracts was $3.9 million at December 31, 2005, of which $0.4 million is recorded in other current assets. The Forward Contracts have been entered into with a major Canadian bank as the counterparty. The risk associated with the Forward Contracts is the cost of replacing these instruments in the event of default by the counterparty. Management believes that this risk is remote.

*Interest Rate Swap Agreements*
The Company entered into interest rate swap agreements on August 31, 2005. The contracts were purchased to mitigate the cash flow risk associated with the impact of changing interest rates or payments due under the Credit Facility. The agreements do not qualify as a cash flow hedge for accounting purposes and the change in the fair value of the derivative is recorded in income. The fair value of these agreements was a net amount of $0.7 million at December 31, 2005, of which $0.06 million is recorded in other current assets.

## 15. Related party transactions

The Company has a Management Agreement in place with Primary Energy Ventures LLC (the "Manager"). The Management Agreement has an initial 20-year term. The Manager provides various management and administrative services to PERC and its subsidiaries under terms defined in the Management Agreement. The Manager is entitled to an incentive fee under the Management Agreement equal to 25% of the product of (a) the excess of the Company's Distributable Cash per EIS and (b) the weighted average number of EISs, Common Shares not represented by EISs and Class B Common Interests outstanding for such fiscal year. For the 130 day period ended December 31, 2005, the Company generated Distributable Cash (before payment of the management incentive fee) of $16.3 million and the Manager will receive $1.2 million as a management incentive fee. The incentive fee is designed to align the financial interests of the Manager with those of the Company and is in addition to the annual management fee. In accordance with the Management Agreement, the Company recorded management fees of $1.1 million and management incentive fees of $1.2 million for the period ended December 31, 2005.

As of December 31, 2005, the Company had a payable due to PEH of $0.2 million and a payable due to the Manager of $0.2 million. The Company has the ability and intent to settle these amounts.

## 16. Basic and Diluted net loss per share

Basic and Diluted net loss per share has been calculated using the weighted average number of Common Shares outstanding during the period of 30,326,923. During the period ended December 31, 2005, there were no potentially dilutive securities outstanding.

## 17. Supplemental Cash Flow Information

The Company paid $5.2 million in cash for interest during the period from August 24, 2005 to December 31, 2005. No cash amounts were paid during the period for income taxes.

## 18. Comparative Figures

The Company was incorporated on June 10, 2005 and did not complete the Offering until August 24, 2005. Consequently, there are no comparative figures for previous periods.

## 19. Segment Reporting

The Company owns and operates facilities designed to recycle waste energy under one operating segment. The Company serves as a single source of supply for its customers' related requirements. The Company's operations are located in the United States. All sales revenue is generated from the same geographic area.