# PRIMARY ENERGY RECYCLING CORPORATION

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

**Three Months and Nine Months Ended September 30, 2006**

## TABLE OF CONTENTS

## Primary Energy Recycling Corporation
## CONSOLIDATED BALANCE SHEETS
*(In thousands of U.S. dollars)*
*(Unaudited)*

| **ASSETS** | September 30, 2006 | December 31, 2005 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 14,943 | $ 12,090 |
| Accounts receivable | 11,018 | 14,847 |
| Spare parts inventory | 1,033 | 1,033 |
| Current future tax asset (Note 7) | 3,062 | 1,622 |
| Current portion of foreign currency exchange contracts | 1,944 | 426 |
| Current portion of interest rate swap contract | 426 | 54 |
| Other current assets | 625 | 322 |
| **Total current assets** | 33,051 | 30,394 |
| Non-current assets: | | |
| Property, plant and equipment, net | 252,372 | 260,241 |
| Intangible assets, net | 187,616 | 209,711 |
| Long-term portion of foreign currency exchange contracts | 7,896 | 3,492 |
| Long-term portion of interest rate swap contract | 493 | 639 |
| Deferred finance fees, net | 7,085 | 8,019 |
| Other non-current assets | 207 | 247 |
| **Total assets** | $ 488,720 | $ 512,743 |
| **LIABILITIES, NON-CONTROLLING INTEREST AND SHAREHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 328 | $ 162 |
| Due to affiliates (Note 9) | 687 | 1,534 |
| Accrued property taxes | 3,630 | 5,255 |
| Accrued interest payable | 1,973 | 1,888 |
| Distributions payable | 2,676 | 2,508 |
| Accrued expenses | 2,015 | 2,096 |
| **Total current liabilities** | 11,309 | 13,443 |
| Long-term debt (Note 3) | 221,075 | 217,340 |
| Future tax liability (Note 7) | 61,365 | 59,534 |
| Asset retirement obligation | 2,900 | 2,749 |
| **Total liabilities** | 296,649 | 293,066 |
| Commitments and contingencies (Note 4) | | |
| Non-controlling preferred interest (Note 5) | 13,225 | 13,225 |
| Non-controlling common interest (Note 5) | 29,030 | 36,418 |
| Shareholders' equity: | | |
| Common stock (Note 6) | 178,571 | 178,571 |
| Shareholders' deficit | (28,755) | (8,537) |
| **Total shareholders' equity** | 149,816 | 170,034 |
| **Total liabilities, non-controlling interest and shareholders' equity** | $ 488,720 | $ 512,743 |

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

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

| | Three Months Ended September 30, 2006 | Period from August 24, 2005 to September 30, 2005 | Nine Months Ended September 30, 2006 | Period from August 24, 2005 to September 30, 2005 |
|---|---|---|---|---|
| **Revenue:** | | | | |
| Capacity | $ 9,018 | $ 3,782 | $ 27,054 | $ 3,782 |
| Energy Service | 12,159 | 5,383 | 41,743 | 5,383 |
| | 21,177 | 9,165 | 68,797 | 9,165 |
| **Expenses:** | | | | |
| Operations and maintenance | 7,197 | 2,945 | 24,650 | 2,945 |
| General and administrative | 2,457 | 935 | 7,275 | 935 |
| Depreciation and amortization | 9,981 | 4,117 | 29,983 | 4,117 |
| **Operating income** | 1,542 | 1,168 | 6,889 | 1,168 |
| **Other income (expense):** | | | | |
| Interest income (expense), net | (5,194) | (2,166) | (15,378) | (2,166) |
| Unrealized gain (loss) on derivative hedge contracts | (2,279) | 5,672 | 6,148 | 5,672 |
| Unrealized gain (loss) on foreign currency translation | 23 | (2,679) | (3,736) | (2,679) |
| **Income (Loss) before income taxes** | (5,908) | 1,995 | (6,077) | 1,995 |
| Income tax benefit (expense) | 363 | 111 | (593) | 111 |
| **Income (Loss) before non-controlling interest** | (5,545) | 2,106 | (6,670) | 2,106 |
| Non-controlling interest in class B Preferred | (381) | (160) | (1,143) | (160) |
| Non-controlling interest in class B Common | 1,751 | (1,436) | 4,196 | (1,436) |
| **Net Income (Loss)** | $ (4,175) | $ 510 | $ (3,617) | $ 510 |
| Shareholders' deficit - beginning of period | (18,887) | - | (8,537) | - |
| Distributions | (5,693) | (2,237) | (16,601) | (2,237) |
| Shareholders' deficit - end of period | $ (28,755) | $ (1,727) | $ (28,755) | $ (1,727) |
| **Weighted average number of shares outstanding** | 31,000,000 | 28,697,368 | 31,000,000 | 28,697,368 |
| **Basic and Diluted net income (loss) per share** (Note 10) | $ (0.14) | $ 0.02 | $ (0.12) | $ 0.02 |

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

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

| | Three Months Ended September 30, 2006 | Period from August 24, 2005 to September 30, 2005 | Nine Months Ended September 30, 2006 | Period from August 24, 2005 to September 30, 2005 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | | |
| Net income (loss) | $ (4,175) | $ 510 | $ (3,617) | $ 510 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 9,981 | 4,117 | 29,983 | 4,117 |
| Unrealized (gain) loss on foreign currency translation | (23) | 2,679 | 3,736 | 2,679 |
| Unrealized (gain) loss on foreign currency exchange contracts and interest rate swaps | 2,279 | (5,672) | (6,148) | (5,672) |
| Non-controlling Class B preferred interest | 381 | 160 | 1,143 | 160 |
| Non-controlling Class B common interest | (1,751) | 1,436 | (4,196) | 1,436 |
| Amortization of deferred finance fees | 312 | 128 | 934 | 128 |
| Income taxes | (363) | (111) | 593 | (111) |
| Accretion of asset retirement obligations | 50 | 19 | 151 | 19 |
| Changes in operating assets and liabilities: | | | | |
| Accounts receivable | (704) | (597) | 3,829 | (597) |
| Other assets | (410) | (686) | (264) | (686) |
| Accounts payable | (113) | 123 | 166 | 123 |
| Accrued property tax | (789) | (1,087) | (1,625) | (1,087) |
| Accrued interest payable | 20 | 2,179 | 85 | 2,179 |
| Accrued expenses | (2,044) | (598) | (81) | (598) |
| Amounts owed to affiliates | (1,672) | (315) | (847) | (315) |
| Net cash provided by operating activities | 979 | 2,285 | 23,842 | 2,285 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | | |
| Business acquistions, net of cash acquired of $5,482 | - | (157,911) | - | (157,911) |
| Purchase of Class B Minority Interest Shares upon exercise of over-allotment option | - | (20,237) | - | (20,237) |
| Capital expenditures | (18) | - | (18) | - |
| Net cash used in investing activities | (18) | (178,148) | (18) | (178,148) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | | |
| Net proceeds from sale of initial public offering common shares | - | 163,393 | - | 163,393 |
| Net proceeds from sale of common shares upon exercise of over-allotment option | - | 15,178 | - | 15,178 |
| Debt issuance | - | 209,690 | - | 209,690 |
| Net proceeds from sale of subordinated notes upon exercise of over-allotment option | - | 5,339 | - | 5,339 |
| Payments on long-term debt | - | (160,009) | - | (160,009) |
| Payment of deferred financing fees | - | (8,458) | - | (8,458) |
| Payment of predecessor debt prepayment penalties | - | (37,594) | - | (37,594) |
| Distributions on non-controlling Class B preferred interest | (381) | - | (1,143) | - |
| Distributions on non-controlling Class B common interest | (1,164) | - | (3,346) | - |
| Distributions on Common Shares | (5,693) | - | (16,482) | - |
| Net cash provided by (used in) financing activities | (7,238) | 187,539 | (20,971) | 187,539 |
| Net increase (decrease) in cash | (6,277) | 11,676 | 2,853 | 11,676 |
| Cash - beginning of period | 21,220 | - | 12,090 | - |
| Cash - end of period | $ 14,943 | $ 11,676 | $ 14,943 | $ 11,676 |

**Supplemental disclosure of cash flow information:**

| | | | | |
|---|---|---|---|---|
| Cash paid during the period for interest | $ 5,268 | $ - | $ 15,144 | $ - |

The accompanying notes are an integral part of these unaudited interim 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. The Company initiated business activity on August 24, 2005 upon completion of an initial public offering (the "Offering"). In conjunction with the Offering, the Company acquired a majority interest in Primary Energy Recycling Holdings, LLC ("PERH"). The non-controlling interest 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.

## 2. Basis of Presentation

The accompanying interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") for interim financial information and do not contain all of the disclosures required for annual financial statements. Accordingly, the interim consolidated financial statements and related notes included herein are unaudited and should be read in conjunction with the annual consolidated financial statements and related notes for the year ended December 31, 2005, included in the Company's 2005 Annual Report. These statements have been prepared following the same accounting policies and methods of computation as the annual consolidated financial statements of the Company for the year ended December 31, 2005 and include all normal recurring adjustments which management considers necessary for fair presentations. Certain amounts in the prior period financial statements and related notes have been reclassified to conform to the 2006 presentation.

## 3. Long-Term Debt

*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. None of the revolving credit facility has been drawn as of September 30, 2006. 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 three and nine month period ended September 30, 2006 the interest rate was defined using an average LIBOR rate of (5.3% plus 2.75%) and (4.9% plus 2.75%), respectively. 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 U.S. $59.3 million or Cdn$71.25 million (as denominated in Canadian dollars using an exchange rate of Cdn$1.20235 per U.S. $1.00). In connection with the Offering, the Company also issued the equivalent of U.S. $15.4 million or Cdn$18.5 million (denominated in Canadian dollars using an exchange rate of Cdn$1.20235 per U.S. $1.00) of Separate Subordinated Notes with a stated annual interest rate of 11.75% and a term of 12 years. Upon exercise of the Over-Allotment Option, an additional U.S. $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. For the nine month period ended September 30, 2006, the Company recorded a loss on foreign currency translation of $3.7 million related to these notes denominated in Canadian dollars. Amounts payable under these notes in U.S. dollars at September 30, 2006, have been adjusted to reflect the change in foreign exchange rates. The Subordinated and Separate Subordinated Notes are collateralized by unsecured guarantees of the Company's subsidiaries.

As of September 30, 2006 and December 31, 2005, the Company is in compliance with all debt covenant requirements.

## 4. Commitments and Contingencies

***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

Management is not aware of any legal or regulatory issues relating to compliance with environmental or safety and health standards that would have a material impact on the business.

## 5. Non-Controlling Interest

Non-controlling interest is comprised of the Class B preferred and common interests of PERH and represents a 16.8% financial interest. Each Class B common interest 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.

## 6. Common Stock

Each EIS consists of one Common Share and Cdn$2.50 of aggregate principal amount of 11.75% Subordinated Notes (Note 3).

*(In thousands of U.S. dollars, except share and per share amounts)*

## 7. Income Taxes

Income tax expense (benefit) consists of the following:

| | Three Months Ended September 30, 2006 | | Nine Months Ended September 30, 2006 | |
|---|---|---|---|---|
| **Current tax provision:** | | | | |
| Federal | $ | (116) | $ | 160 |
| State | | (31) | | 42 |
| Total current tax | | (147) | | 202 |
| **Future tax provision:** | | | | |
| Federal | | (171) | | 309 |
| State | | (45) | | 82 |
| Total future tax | | (216) | | 391 |
| Total tax expense (benefit) | $ | (363) | $ | 593 |

The principal items which cause the Company's effective tax rate in 2006 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:

| | Three Months Ended September 30, 2006 | | Nine Months Ended September 30, 2006 | |
|---|---|---|---|---|
| Income tax expense (benefit) at Canadian Statutory Rate: | $ | (2,133) | $ | (2,195) |
| Additional tax expense (benefit) from operations in countries with different income tax rates | | (259) | | (266) |
| Valuation Allowance | | 2,029 | | 3,054 |
| Total tax expense (benefit) | $ | (363) | $ | 593 |

The Company recorded a net future tax liability at the date of acquisition representing the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The basis differences in the property, plant and equipment and intangible asset balances are being depreciated or amortized over the useful lives of these assets. This depreciation and amortization expense is fully allocated to the non-controlling shareholders through the non-controlling common interest in class B common line item of the statement of operations. These amounts do not create a liability or expense for EIS and common share holders and will not impact the Company's future cash flows. Future income tax expense relates to the increase in the future tax liability as reflected on the December 31, 2005 balance sheet as compared to the future tax liability at September 30, 2006. At inception, substantially all of the net future tax liability was the result of the differences in the basis of those assets and liabilities contributed by the non-controlling shareholders.

*(In thousands of U.S. dollars, except share and per share amounts)*

Significant components of the future tax assets and (liabilities) are as follows:

| | As of September 30, 2006 | As of December 31, 2005 |
|---|---|---|
| Accrued Expenses | $ 786 | $ 708 |
| Foreign Currency Translation | 2,449 | 936 |
| **Current Future Tax Assets** | 3,235 | 1,644 |
| Contract Termination Fee | 17,238 | 19,085 |
| Asset Retirement Obligation | 1,175 | 1,113 |
| Net Operating Loss | 5,063 | 2,009 |
| Valuation Allowance | (5,063) | (2,009) |
| **Long-Term Future Tax Assets** | 18,413 | 20,198 |
| Interest Rate Swap | (173) | (22) |
| **Current Future Tax Liability** | (173) | (22) |
| Other | (27) | (46) |
| Fixed Assets | (21,116) | (17,616) |
| Intangible Assets | (26,735) | (31,947) |
| Interest Rate Swap | (200) | (259) |
| Investment in PCI | (31,700) | (29,864) |
| **Long-Term Future Tax Liability** | (79,778) | (79,732) |
| **Net Future Tax Liability** | $ (58,303) | $ (57,912) |

The Company has U.S. and Canadian net operating loss carryforwards that will start to expire in 2025 and 2015, respectively. 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 during the carryforward period. At September 30, 2006 and December 31, 2005 the net current future tax asset balances were $3.1 million and $1.6 million, respectively. At September 30, 2006 and December 31, 2005 the net long term future tax liability balances were $61.4 million and $59.5 million, respectively.

## 8. 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, the non-controlling interest and interest distributions to the separate

subordinate note holders. The contracts are for a series of monthly payments through September 2010. At September 30, 2006, forty eight sets of payments comprised of three monthly 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 Cdn$1.1712 to U.S. $1.00 and a rate of Cdn$1.0840 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 U.S. $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 $9.8 million at September 30, 2006, of which $1.9 million is recorded in 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 $0.9 million at September 30, 2006, of which $0.4 million is recorded in current assets.

## 9. Related party transactions

The Company has a Management Agreement in place with the Manager. The Management Agreement has an initial 20-year term. The Manager provides various management and administrative services to the Company and its subsidiaries under terms defined in the Management Agreement. As described in the Management Agreement, the Manager is entitled to an incentive fee equal to 25% of the product of (a) the excess of the Company's distributable cash per Common Share of the Company 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 nine month period ended September 30, 2006, the Company generated distributable cash (before management incentive fee) of $28.3 million and accrued an estimated management incentive fee of $0.6 million. The management incentive fee is paid annually based upon year end results, is designed to align the financial interests of the Manager with those of the Company and is in addition to the annual management fee. During the nine months ended September 30, 2006, in accordance with the Management Agreement, the Company recorded management fees of $2.3 million.

As of September 30, 2006, the Company had a payable balance due to the Manager of $0.7 million inclusive of the incentive fee accrual. The Company has the ability and intent to settle this amount.

**10. Basic and Diluted net income (loss) per share**

Basic and Diluted net income (loss) per share has been calculated using the weighted average number of Common Shares outstanding of 31,000,000 for the three month and nine month periods ended September 30, 2006, and 28,697,638 for the thirty eight day period ended September 30, 2005. For the three month and nine month periods ended September 30, 2006 and the thirty eight day period ended September 30, 2005, there were no potentially dilutive securities outstanding.

**11. Comparative Figures**

The Company was incorporated on June 10, 2005 and did not begin operations until August 24, 2005. Consequently, there are no comparative figures for periods prior to August 24, 2005.

**12. 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.

**13. Subsequent Event**

On November 1, 2006, the Manager was acquired by EPCOR Power L. P., a Canadian Public Company. In connection with the acquisition, there were changes made to the Designated Employees of the Manager and the Company made certain changes to the composition of the Board of Directors. The Manager will continue to provide management services to the Company under its existing management agreement. As a result of this transaction, the deferred tax liability of approximately $50.0 million ascribed to the non-controlling interest as described in Note 7 will be written off to non-controlling interest on the balance sheet by recording a tax benefit and a corresponding specific allocation to non-controlling interest in the consolidated statement of operations. The Company has filed a Material Change Report dated November 1, 2006 on SEDAR at www.sedar.com that provides additional disclosure related to the transaction.