PRIMARY ENERGY RECYCLING CORPORATION

Management's Discussion and
Analysis of Financial Condition and Results of Operations
(In US Dollars)

Year Ended December 31, 2006 and
Period from August 24, 2005 to December 31, 2005

Primary Energy Recycling Corporation
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following management's discussion and analysis of the financial condition and results of operations ("MD&A") of Primary Energy Recycling Corporation (the "Company") dated March 7, 2007 should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2006. The Company's financial statements are prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). All amounts described in the management MD&A are in thousands of U.S. dollars, unless otherwise stated.

Forward-Looking Statements

Certain statements in this MD&A may constitute ''forward-looking statements'', which reflect the expectations of management regarding future growth, results of operations, performance and business prospects and opportunities of the Company. Such forward-looking statements reflect current expectations regarding future events and operating performance and speak only as of December 31, 2006. These forward-looking statements involve significant risks and uncertainties, and should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under ''Risk Factors'' in this MD&A and in the Company's Annual Information Form dated March 8, 2007. Additional information relating to the Company, including its Annual Information Form, is available on SEDAR at www.sedar.com. Although the forward-looking statements contained in this MD&A are based upon what are believed to be reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this MD&A and the Company assumes no obligation to update or revise them to reflect new events or circumstances.

Overview

General

The Company owns a majority interest in Primary Energy Recycling Holdings LLC ("PERH") which is headquartered in Oak Brook, Illinois. PERH indirectly owns and operates four recycling energy projects and a 50% interest in a pulverized coal facility (collectively, the ''Projects''). The Projects have a combined electrical generating capacity of 283 megawatts and a combined steam generating capacity of 1.8 MMlbs/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.

On August 24, 2005, the Company completed an initial public offering (the "Offering") through the issuance of 28.5 million enhanced income securities ("EISs") at a price of Cdn$10.00 per EIS, each representing one common share of the Company ("Common Share") and Cdn$2.50 principal amount of 11.75% subordinated notes ("Subordinated Notes"). In addition, the Company issued Cdn$18.5 million separate Subordinated Notes (not forming part of EISs) ("Separate Subordinated Notes") with the same terms as the EIS Subordinated Notes. A new credit facility was also entered into contemporaneously with the Offering consisting of a term loan facility of $135.0 million and a $15.0 million revolving credit facility (the "Credit Facility"). On September 27, 2005, the underwriters of the Offering exercised their over-allotment option to purchase 2.5 million additional EISs.

The Company used the proceeds of the Offering, and the proceeds of the over-allotment, to acquire an ownership interest in PERH. On completion of the Offering and closing of the over-allotment, the

Company owned 85.8% of the preferred interests and 83.0% of the common interests in PERH, through its ownership of all of the issued and outstanding Class A preferred membership interests and all of the issued and outstanding Class A common membership interests of PERH. Primary Energy Ventures LLC (the "Manager"), indirectly holds the remaining 14.2% of the preferred interests and 17.0% of the common interests in PERH, through its ownership of all of the issued and outstanding Class B preferred membership interests and all of the issued and outstanding Class B common membership interests in PERH.

Matters Affecting Comparability

The Company began operations on August 24, 2005, the same day the Company completed the Offering. There are no financial statements for the 2005 fiscal year for the Company (or its subsidiaries) that can be used on a comprehensive basis for comparing the year ended December 31, 2006 operating results to the comparative period in the prior period. In order to enhance its usefulness, this MD&A includes a summary of the operating results of the Company for the year ended December 31, 2006 and comparative pro forma operating results for the corresponding year ended December 31, 2005. The pro forma operating results for the year ended December 31, 2005 have been prepared by combining the financial results of the Company for the period from August 24, 2005 to December 31, 2005 (representing the results of the Company for the period subsequent to the Offering) with the financial results of the predecessor Company for the period from January 1, 2005 to August 23, 2005 (representing the results of the Company for the period prior to the Offering). As a portion of the fiscal 2005 period represents a period prior to the closing of the Offering, this information is provided for reference purposes only, and is not intended as a comprehensive comparison of financial results. In addition, the results for the year ended December 31, 2006 reflect a net reduction in unrealized gain on derivative hedge contracts of $0.5 million for excess unrealized gain recognized in the prior periods.

Definitions of EBITDA and Distributable Cash

References to ''EBITDA'' are to earnings before interest, taxes, depreciation, amortization and certain other adjustments listed in the reconciliation table provided herein. References to "Distributable Cash" are to EBITDA, as adjusted for: interest on the Credit Facility and interest on the Separate Subordinated Notes. EBITDA and Distributable Cash are not recognized measures under Canadian GAAP and do not have standardized meanings prescribed by Canadian GAAP. Therefore, EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. The Company intends to distribute substantially all of its cash excluding those amounts required for operation of the business on an ongoing basis. Accordingly, management believes that EBITDA and Distributable Cash are important measures in evaluating the Company's performance. However, EBITDA and Distributable Cash should not be construed as an alternative to net earnings or loss determined in accordance with Canadian GAAP as an indicator of the Company's performance or to cash flows from operating, investing and financing activities, as a measure of liquidity and cash flows.

Primary Energy Recycling Corporation
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations
(in 000's of US$, except per share data)

	For the Years Ended December 31,			
			Predecessor	
		Actual	Pro forma	
	Actual	130 Days	235 Days	Pro forma
	2006	8/24/05 - 12/31/05	1/1/05 - 8/23/05	2005
			(Note 1)	(Note 1)
Revenue:				
Capacity	$ 36,071	$ 12,800	$ 23,271	$ 36,071
Energy Service	51,001	19,599	25,942	45,541
	87,072	32,399	49,213	81,612
Expenses:				
Operations and maintenance	31,423	7,549	15,895	23,444
General and administrative	9,286	5,744	5,287	11,031
Depreciation and amortization	40,400	14,405	8,295	22,700
Total Operating Expenses	81,109	27,698	29,477	57,175
Operating income	$ 5,963	$ 4,701	$ 19,736	$ 24,437
Other income (expense):				
Interest income (expense), net	(20,594)	(7,211)		
Unrealized gain (loss) on derivative hedge contracts	(1,297)	4,612		
Unrealized loss on foreign currency translation	(36)	(2,310)		
Loss before income taxes	(15,964)	(208)		
Income tax benefit (expense)	54,884	(1,925)		
Income (Loss) before non-controlling interest	38,920	(2,133)		
Non-controlling interest in class B Preferred	(1,523)	(537)		
Non-controlling interest in class B Common	(55,854)	1,706		
Net Loss	$ (18,457)	$ (964)		
Weighted average number of shares outstanding	31,000,000	30,326,923		
Basic and Diluted net loss per share (Note 2)	$ (0.60)	$ (0.03)		

Note 1: Proforma financial data has been adjusted to reflect investment in PCI Associates on a proportionate consolidation basis for all periods presented and to remove the financial results of Lakeside Energy LLC from historical predecessor financial results.

Note 2: Basic and Diluted net loss per share has been calculated using the weighted average number of Common Shares outstanding of 31,000,000 for the year ended December 31, 2006 and 30,326,923 for the period from August 24, 2005 to December 31, 2005.

Balance Sheet Data

(In 000's of US$)

	As of December 31,	
	2006	2005
Total assets	$ 465,521	$ 511,807
Total long-term liabilities	$ 224,893	$ 278,687

Year Ended December 31, 2006 compared to Pro forma Year Ended December 31, 2005

The Company's revenue of $87.1 million in 2006 increased $5.5 million, or 6.77% compared with pro forma revenue of $81.6 million in 2005. This increase reflects an improvement in Energy Service revenue, primarily resulting from increased revenue at the Company's Harbor Coal facility of $5.7 million due to increases in volume of $2.1 million and pricing of $3.6 million which is due to the spread between the cost of coal supplied and the prices of the fuels that coal replaces (coke, natural gas and fuel oil).

Operating and maintenance expense in 2006 was $31.4 million compared to $23.4 million for pro forma 2005, an increase of $8.0 million or 34.0%. The increase was due to additional plant maintenance expenses in 2006 comprised of planned steam turbine overhaul expenses of $0.8 million and additional processing expenditures of $3.5 million (corresponding to increased revenue at the Company's Harbor Coal facility). In addition, Harbor Coal also experienced higher prices for production commodities including oxygen, nitrogen and labor resulting in increased costs of $3.7 million. As a percentage of revenue, operating and maintenance expenses increased to 36.1% in 2006 from 28.7% in pro forma 2005.

General and administrative expense in 2006 was $9.3 million compared to $11.0 million for pro forma 2005, a decrease of $1.7 million or 16.0%. The decrease was the result of a $1.8 million reduction in property tax expense inclusive of property tax refunds and a reduction in accrued property taxes based upon completion of a successful appeal to the state taxing authorities for designation as a non-utility taxpayer. In addition, there was a $1.2 million reduction in incentive fees in 2006. These reductions are offset by additional general and administrative expenses associated with professional fees of $0.4 million, plant and liability insurance of $0.3 million, management fees of $0.2 million, accretion of $0.2 million and board compensation fees of $0.2 million. As a percentage of revenue, general and administrative expenses decreased to 10.7% in 2006 from 13.5% in pro forma 2005.

Depreciation expense in 2006 was $10.5 million compared to $9.9 million for pro forma 2005, an increase of $0.6 million. The increase in depreciation expense was associated with the fair value adjustment to fixed assets resulting from the allocation of purchase price upon the completion of the Offering. As a percentage of revenue, depreciation expense decreased to 12.0% in 2006 from 12.1% in pro forma 2005.

Amortization expense in 2006 was $29.9 million compared to $12.8 million for pro forma 2005, an increase of $17.1 million. The increase was due to the additional amortization associated with the allocation of purchase price to Contract Value intangible asset upon the completion of the Offering. The Contract Value intangible asset is being amortized over an average term of 8 years. As a percentage of revenue, amortization expense increased to 34.3% in 2006 from 15.7% in pro forma 2005.

Operating income in 2006 was $6.0 million compared to $24.4 million for pro forma 2005, a decrease of $18.4 million, or 75.6%. The decrease was primarily driven from the net effect of the items discussed above.

Interest Expense, Unrealized Loss on Derivative Contracts and Income Tax Benefit Reflected in the Year Ended December 31, 2006 Net Loss

Interest expense recorded in 2006 was $20.6 million comprised of $10.7 million of interest on the term loan facility, $9.6 million of interest on the Subordinated Notes and Separated Subordinated Notes and $1.4 million of interest related to the amortization of deferred finance fees. These amounts are offset by $1.1 million of interest income.

An unrealized loss on derivative hedge contracts of $1.3 million was recorded in 2006 and reflects the change in fair value from December 31, 2005 to December 31, 2006 associated with financial hedges.

The income tax benefit recorded in 2006 of $54.9 million was primarily the result of the elimination of the remaining deferred tax liability balance of $57.3 million ascribed to the non-controlling interest upon the sale of the non-controlling interest on November 1, 2006, offset by tax expense of $2.4 million. The deferred tax liability originated on August 24, 2005, the closing of the Offering, and represents the tax basis differential associated with the assets and liabilities contributed to PERH by the non-controlling interest in conjunction with the Offering. As this deferred tax liability was ascribed to the non-controlling interest, the elimination recorded in 2006 is allocated to the non-controlling interest through the "Non-controlling interest in Class B Common" line in the Statement of Operations.

Fourth Quarter 2006 compared to Fourth Quarter 2005

The Company's revenue of $18.3 million in the fourth quarter of 2006 decreased by $4.9 million, or 21.3% compared with revenue of $23.2 million for the fourth quarter of 2005. The decline in revenue for the quarter was primarily the result of decreased revenue at the Company's Harbor Coal facility driven by an annual consumption adjustment recorded at year end based on physical inventory counts completed by Harbor Coal's joint venture host customer. In 2006, the effect of the adjustment was to increase coke consumption which impacted the amount of revenue recorded by the joint venture. The effect of this adjustment reduced fourth quarter revenue at Harbor Coal by $3.2 million. Additionally, decreased volume at Harbor Coal during the fourth quarter of 2006 compared to corresponding activity in the fourth quarter of 2005 resulted in an additional reduction in fourth quarter 2006 revenue of $1.2 million. Additionally, revenue in the fourth quarter of 2006 decreased by $0.8 million due in large part to an outage and increased by $0.3 million due to increased volume.

Operating and maintenance expense for the fourth quarter of 2006 was $6.8 million compared to $4.6 million for the fourth quarter of 2005, an increase of $2.2 million or 47.1%. The increase was primarily due to additional plant maintenance expenses at the Harbor Coal's joint venture facility. In the fourth quarter of 2005, Harbor Coal's joint venture investment was favorably impacted by an annual consumption adjustment associated with coal consumption which reduced fees charged to operating and maintenance expense by $2.2 million compared to fourth quarter of 2006.

General and administrative expense for the fourth quarter of 2006 was $2.0 million compared to $4.8 million for the fourth quarter of 2005, a decrease of $2.8 million or 58.2%. The decrease was comprised of fourth quarter 2006 reductions in management incentive fee of $1.8 million, property taxes of $0.6 million, professional fees of $0.3 million and board compensation fees of $0.1 million.

Primary Energy Recycling Corporation
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Summary of Quarterly Results

(In 000's of US$, except per share data)

	Period from 8/24 - 9/30 2005	4th Quarter 2005	1st Quarter 2006	2nd Quarter 2006	3rd Quarter 2006	4th Quarter 2006
Revenues	$ 9,165	$ 23,234	$ 25,718	$ 21,902	$ 21,177	$ 18,275
Net income (loss)	$ 510	$ (1,474)	$ (1,316)	$ 1,874	$ (4,175)	$ (14,840)
Net income (loss) per share	$ 0.02	$ (0.05)	$ (0.04)	$ 0.06	$ (0.14)	$ (0.48)

Outstanding Share Data

At February 28, 2007, the Company had 31,000,000 Common Shares outstanding, of which 223,900 Common Shares were held separately and the remaining 30,776,100 Common Shares were held as a component of EIS's. Each EIS consists of one Common Share and Cdn$2.50 principal amount of 11.75% Subordinated Notes of the Company.

Loss Per Share

Basic loss per share is computed based on the weighted average number of Common Shares outstanding. During the year ended December 31, 2006, there were no potentially dilutive securities issued and outstanding. Accordingly, diluted loss per share is equivalent to basic loss per share.

Liquidity and Capital Resources

During 2006, the Company increased cash and cash equivalents by $3.6 million to a balance of $15.6 million as of December 31, 2006. The Company believes these funds, in addition to cash generated from future operations and available credit facilities of $15.0 million are expected to be sufficient to finance known or foreseeable liquidity and capital needs. The Company's primary source of liquidity has historically been cash flow from operations. Additionally, management believes that the Company's ability to generate positive cash flow from operations will be sufficient to meet anticipated maintenance requirements associated with the Company's facilities in the near term and over the long term. The Company has one overhaul planned for 2007 with an estimated cost of $0.9 million.

Cash Flows for the Year Ended December 31, 2006

Net cash provided by operating activities for the year ended December 31, 2006 was $31.8 million, which resulted from a $18.5 million net loss, plus $45.7 million of net non-cash items charged to the Consolidated Statement of Operations, plus $4.6 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment. The net change in operating assets and liabilities resulted primarily from a decrease in accounts receivable and an increase in accounts payable, offset by reductions in accrued property taxes, accrued expenses and amounts owed to affiliates.

Net cash used in financing activities for the year ended December 31, 2006 was $28.2 million resulting primarily from interest and distribution payments of $26.7 million to holders of Class A common membership and B common membership interests in PERH.

Cash Flows for the Period from August 24, 2005 to December 31, 2005

Net cash provided by operating activities for the period from August 24, 2005 to December 31, 2005 was $9.6 million, which resulted from a $1.0 million net loss, plus $13.4 million of net non-cash items charged to the Consolidated Statement of Operations, less $2.8 million representing the net change in the Company's operating assets and liabilities. The net non-cash items consisted primarily of depreciation of property, plant and equipment offset by unrealized gains on derivative hedge contracts. The net change in operating assets and liabilities resulted primarily from a decrease in accounts receivable and an increase in accounts payable offset by reductions in accrued property taxes, accrued expenses and amounts owed to affiliates.

Net cash provided by financing activities for the period from August 24, 2005 to December 31, 2005 was $180.6 million resulting primarily from proceeds from the issuance of EIS securities and long term debt totaling $393.6 million. This amount was offset by payments of debt totaling $206.1 million and interest and distribution payments of $6.9 million to Class A and B equity holders.

Outstanding Debt

At December 31, 2006, the amount of outstanding debt under the Credit Facility was $135.0 million, with $15.0 million in additional borrowing capacity available under the revolving credit facility for working capital purposes. Also included in outstanding debt is $82.4 million in Subordinated Notes and Separate Subordinated Notes. The Credit Facility has a maturity date of August 24, 2009. The Subordinated Notes and Separate Subordinated Notes have a 12-year term and are due and payable on August 24, 2017. The Credit Facility, as well as the terms of the Subordinated Notes and Separate Subordinated Notes, requires the Company to meet certain financial covenants including, among other things, maintaining certain defined leverage and coverage ratios. As of December 31, 2006, the Company was in compliance with all such debt covenant requirements.

Cash Available for Distribution

The Company pays interest on the Subordinated Notes as stipulated and distributions on the Common Shares (when declared) in equal monthly amounts. Declarations of distributions on the Common Shares are based on periodic reviews of its estimated annual earnings and related estimated annual cash flows. For the year ended December 31, 2006, the Company generated Cdn$39.5 million of Distributable Cash and distributed Cdn$42.3 million, for a payout ratio of 107.1%. For the period from August 24, 2005 to December 31, 2005, the Company generated Cdn$17.6 million of Distributable Cash and distributed Cdn$14.5 million, for a payout ratio of 82.6%. Since inception, the Company has generated Cdn$57.1 million and distributed Cdn$56.8 million, for a payout ratio of 99.5%. The Board of Directors monitors the distribution policy of the Company with respect to excess cash, forecasted cash flows, debt levels and spending plans for the long term and may adjust distributions to retain appropriate liquidity for business operations. The Company expects to follow its distribution policy summarized in its Annual Information Form dated March 8, 2007 available on SEDAR at www.sedar.com.

Distributable Cash Summary

(in 000's of US$, except per share data and as otherwise indicated)

	Year Ended December 31, 2006	130 Days Ended December 31, 2005	August 24, 2005 to December 31, 2006
Reconciliation of net loss to EBITDA:			
Net loss	$ (18,457)	$ (964)	$ (19,421)
Plus:			
Depreciation and Amortization	40,400	14,405	54,805
Interest expense	20,594	7,211	27,805
Unrealized (gain) loss on foreign currency exchange	36	2,310	2,346
Unrealized (gain) loss on derivative hedge contracts	1,297	(4,612)	(3,315)
Income tax expense (benefit)	(54,884)	1,925	(52,959)
Non-controlling interest	55,854	(1,706)	54,148
Distributions on Class B preferred interest	1,523	537	2,060
EBITDA (Note 1)	$ 46,363	$ 19,106	$ 65,469
Less:			
Interest and related charges on new credit facility	10,744	3,409	14,153
Interest on separate subordinated notes	1,856	659	2,515
Distributable Cash (Note 1)	$ 33,763	$ 15,038	$ 48,801
Per Common and equivalent Common Share (Note 2)	$ 0.91	$ 0.40	$ 1.31
Interest on EIS Subordinated Notes	$ 7,776	$ 2,759	$ 10,535
Distributions on Common Shares	22,293	7,572	29,865
Distributions on non-controlling Class B preferred interest	1,523	537	2,060
Distributions on non-controlling Class B common interest	4,558	1,548	6,106
Total distributions (Note 3)	$ 36,150	$ 12,416	$ 48,566
Per Common and equivalent Common Share (Note 2)	$ 0.97	$ 0.33	$ 1.30
Hedge rate (Cdn$ per US$) (Note 4)	$ 1.1687	$ 1.1712	$ 1.1695
Distributable Cash (Cdn$) (Note 1)	$ 39,459	$ 17,613	$ 57,073
Per Common and equivalent Common Share (Cdn$) (Note 2)	$ 1.06	$ 0.47	$ 1.53
Excess (shortfall) distributable cash (Cdn$)	$ (2,790)	$ 3,071	$ 275
Per Common and equivalent Common Share (Cdn$) (Note 2)	$ (0.07)	$ 0.08	$ 0.01

Note 1: EBITDA and Distributable Cash are not recognized measures under Canadian GAAP and do not have standardized meanings prescribed by Canadian GAAP. Therefore, EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. As the Company intends to distribute substantially all of its cash on an ongoing basis, management believes that EBITDA and Distributable Cash are important measures in evaluating the Company's performance. Distributable Cash is not intended to be representative of cash flow or results of operations determined in accordance with Canadian GAAP.

Note 2: Common and equivalent Common Share computation for Distributable Cash purposes assumes 31,000,000 Common Shares are outstanding for the full period and the conversion of Class B common interests into equivalent Common Shares. For the year ended December 31, 2006 and for the period from August 24, 2005 to December 31, 2006, the number of Common and equivalent Common Shares outstanding is 37,265,455.

Note 3: Includes distributions declared, but not distributed in reporting period.

Note 4: Hedge rate is based on weighted average of outstanding hedge contracts in place in each respective period.

	Year Ended December 31, 2006	130 Days Ended December 31, 2005	August 24, 2005 to December 31, 2006
Reconciliation of cash flows from operating activities to Distributable Cash:			
Cash provided by operating activities	$ 31,774	$ 9,598	$ 41,372
Interest on EIS Subordinated Notes	7,776	2,759	10,535
Interest income	(1,027)	(55)	(1,082)
Accretion of asset retirement obligations	(202)	(67)	(269)
Changes in operating assets and liabilities	(4,558)	2,803	(1,755)
Distributable Cash (Note 1)	$ 33,763	$ 15,038	$ 48,801

Note 1: Distributable Cash is not a recognized measure under Canadian GAAP and does not have a standardized meaning prescribed by Canadian GAAP. Therefore, Distributable Cash may not be comparable to similar measures presented by other issuers. As the Company intends to distribute substantially all of its cash on an ongoing basis, management believes that Distributable Cash is an important measure in evaluating the Company's performance. Distributable Cash is not intended to be representative of cash flow or results of operations determined in accordance with Canadian GAAP.

Foreign Currency Exchange Contracts

On closing of the Offering, the Company entered into forward contracts to purchase Canadian dollars sufficient to make monthly distributions through September 2010 at the initial distribution level to all EIS holders, including non-controlling investors, as well as interest payments on the Separate Subordinated Notes. These forward contracts applicable for distributions to EIS holders and the non-controlling interest have an exchange rate of Cdn$1.1712 to U.S. $1.00 and a rate of Cdn$1.0840 to U.S. $1.00. The forward contracts for the Separate Subordinated Notes have an exchange rate of Cdn$1.1713 to U.S. $1.00. For the year ended December 31, 2006, the net impact of the change in the foreign exchange rate on the aggregate value of the hedges resulted in an unrealized loss of $1.5 million. At December 31, 2006, the fair value of these contracts was a net amount of $2.4 million of which $0.3 million is recorded in current assets. For the period from August 24, 2005 to December 31, 2005, the net impact of the change in the foreign exchange rate on the aggregate value of the hedges resulted in an unrealized gain of $3.9 million. At December 31, 2005, the fair value of these contracts was a net amount of $3.9 million of which $0.4 million is recorded in current assets.

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 on 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. For the year ended December 31, 2006, the net impact of the exchange in the fair value of the agreements resulted in an unrealized gain of $0.2 million. At December 31, 2006 the fair value of these agreements was a net amount of $0.9 million of which $0.4 million is recorded in current assets. For the period from August 24, 2005 to December 31, 2005, the net impact of the exchange in the fair value of the agreements resulted in an unrealized gain $0.7 million. At December 31, 2005 the fair value of these agreements was a net amount of $0.7 million of which $0.05 million is recorded in current assets.

Commitments and Contractual Obligations

The following table reflects the Company's contractual obligations and commitments related to outstanding indebtedness as of December 31, 2006, including payments due for each of the next five years and thereafter.

Maturities of long-term debt are as follows (in 000's):

	December 31, 2006 Balance	2007	2008	2009	2010	2011	Thereafter
Term Loan Facility	$ 135,000	$ -	$ -	$ 135,000	$ -	$ -	$ -
Subordinated debt	82,376	-	-	-	-	-	82,376
Total	$ 217,376	$ -	$ -	$ 135,000	$ -	$ -	$ 82,376

The Company pays a management fee under the Management Agreement which continues through August 2025. For more detailed discussion, please see "Transactions with Related Parties".

The Company has no off-balance sheet debt or similar obligations.

Transactions with Related Parties

The Manager is engaged to provide management and administrative services to the Company and its subsidiaries pursuant to the terms of the Management Agreement for which it earns a fixed fee that adjusts annually based on inflation factors. The Manager is also entitled to an incentive fee under the Management Agreement. The incentive fee is designed to align the financial interests of the Manager with those of the Company. The incentive fee for each year will equal 25% of the product of (a) the excess of the Company's Distributable Cash per Common Share and (b) the weighted average number of EISs, Common Shares not represented by EISs and Class B Common Interests outstanding for such fiscal year. The Management Agreement has an initial 20-year term which commenced August 24, 2005.

On November 1, 2006, the Manager was acquired by EPCOR Power L.P. ("EPCOR Power"), a Canadian public company. As a result of the acquisition, all the employees of the Manager were transferred to EPCOR Operations (U.S.) Inc. ("EPCOR Operations"), a wholly owned subsidiary of EPCOR Utilities Inc. and an affiliate of EPCOR Power. EPCOR Operations now provides all management and administrative services to the Manager which continues to act as Manager under the Management Agreement.

In connection with the acquisition of the Manager by EPCOR Power on November 1, 2006, the Company, EPCOR Power, EPCOR Operations, the Manager and Thomas Casten (former Chair and Chief Executive Officer of the Manager) entered into an allocation agreement (the "Allocation Agreement") which allocates among the parties rights to new and certain existing development and acquisition opportunities, where such opportunities have been or will be developed or identified by any of the Manager, EPCOR Operations or Thomas Casten. The principal terms of the Allocation Agreement are summarized in the Company's Annual Information Form dated March 8, 2007 and a copy of the Allocation Agreement is available for review on SEDAR at www.sedar.com.

A detailed description of the principal terms of the Management Agreement is included in the Company's Annual Information Form dated March 8, 2007 and a copy of the Management Agreement is available for review on SEDAR at www.sedar.com.

Critical Accounting Estimates

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, revenues 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.
Accounting policies are considered critical when they require management to make assumptions about matters that are highly uncertain at the time the estimate is made and when different estimates than those management reasonably could have made have a material impact on the presentation of the Company's financial condition, changes in financial condition or results of operations. The following is a description of the Company's accounting policies that management believes require subjective and complex judgments, and could potentially have a material effect on reported financial condition and results of operations.

Property, Plant and Equipment

Property, plant and equipment have been adjusted, giving effect to the purchase method of accounting. Depreciation for all asset classes is recorded 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.

Intangible Assets

Identifiable intangible assets were fair valued based on valuation techniques for the purpose of applying purchase accounting to the acquisition on August 24, 2005 and represent contract rights associated with customer contracts and nitrogen oxide allowances. The respective intangible values are amortized over specified time horizons and evaluated for impairment if events or changes in circumstances indicate that the asset might be impaired. Fair value under Canadian GAAP is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act". Assessing the fair value of intangible assets requires management estimates on future cash flows to be generated by the assets.

Impairment of Long-Lived Assets

Management continually evaluates whether events or circumstances have occurred that indicate that the remaining estimated useful lives of property, buildings and equipment may warrant revision or that the remaining balances may not be recoverable. If this review indicates that the assets will not be recoverable, as determined based on the undiscounted future cash flows from the use of the assets, the carrying value of the assets will be reduced to their estimated fair value.

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 fair value of asset retirement obligations depends on the total undiscounted amount of the estimated cash flows required to settle the obligations and the appropriate credit-adjusted risk-free discount rate. 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, and are included in general

and administrative expenses in the consolidated statement of operations and shareholders' deficit. Actual expenditures incurred are charged against the accumulated obligation.

Revenue Recognition

Revenue is recorded as services are delivered. 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 and is billed on a monthly basis. Energy Service revenue represents the revenue earned based on measurements of services performed and delivered each period. The Company provides estimates for doubtful accounts it deemed necessary based on the aging category and specific knowledge of the customers ability to pay. No such allowances were recorded at December 31, 2006 and 2005.

Future Income Taxes

The Company utilizes the liability method of accounting for income taxes under which future income tax assets and liabilities are recognized based upon the differences between the tax basis of an asset or liability and its reported amount in the financial statements. Future tax balances are determined by using estimates of future tax rates expected to be in effect when the taxes will actually be paid or refunds received.

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 estimated fair value, with changes in fair value recognized currently in earnings.

Risk Factors

The Company's future performance and ability to generate sufficient cash flow to meet its monthly cash distributions to holders of EISs, and the Common Shares and Subordinated Notes represented thereby, involves a number of risks and uncertainties. Any of these risks and uncertainties could have a material adverse effect on results of operations, business prospects, financial condition, the cash available for distribution to holders of EISs, Common Shares, or Subordinated Notes or on the market price or value of EISs, Common Shares or Subordinated Notes. The following is a partial listing of primary risks facing the Company. Additional risks are discussed in the Company's Annual Information Form dated March 8, 2007 and are available for review on SEDAR at www.sedar.com.

Revenue May be Reduced upon Expiration or Termination of Agreements

Energy generated by the Company's four recycled energy Projects, in most cases, is provided to customers under agreements that expire at various times. In addition, these agreements may be subject to termination in certain circumstances, including, without limitation, default by the Project owner or operator. When such a contract expires or is terminated, there can be no assurance that it will be renewed. Furthermore, even if such agreements are renewed it is possible that the price received by the relevant Project for energy or capacity under subsequent arrangements may be reduced significantly. It is possible that subsequent contracts may not be available at prices or under terms that permit the operation of a Project on a profitable basis. If this occurs, the affected Project may temporarily or permanently cease operations.

Dependence on Key Personnel
PERH's success is largely dependent on the skills, experience and efforts of the senior management team of the Manager and other key personnel of EPCOR Operations. The loss of the services of any key employee could materially harm PERH's business, financial condition, future results and cash flow. Although to date PERH has been successful in retaining the services of senior management, such members of senior management may terminate their employment agreements without cause. The Manager may also not be able to locate or employ on acceptable terms qualified replacements for its senior management or key employees if their services were no longer available. PERH has entered into agreements with such members of senior management which prohibit them from competing with or soliciting employees or customers of PERH during and for 12 months following cessation of their employment.

Dependence on the Manager and Potential Conflicts of Interest
PERH and the Company are dependent on the Manager and EPCOR Operations in respect of the administration and management of PERH and the Company and the operations of the Projects. Although the Management Agreement has an initial 20-year term, the Management Agreement may be terminated earlier in certain circumstances, including by the Manager upon 180 days' prior written notice. Upon termination, PERH and the Company are required to establish replacement arrangements. If PERH and the Company are not able to obtain such arrangements on favorable terms, revenues and profits may decline and Distributable Cash of the Company may be negatively affected.

Certain officers of the Manager are full-time employees of EPCOR Operations and will devote their time and efforts exclusively to or for the benefit of the business of PERH and the Company. The Manager and its affiliates (which, for greater certainty, includes EPCOR Power and its subsidiaries) and employees or agents may be engaged or invest directly or indirectly in a variety of other companies or other entities involved in owning, managing or advising on or otherwise engaged in the business of the generation, production, transmission, distribution, purchase and sale of electricity, other forms of energy-related projects, infrastructure projects, utility projects or other businesses.

Other than the specific requirements of the Allocation Agreement, neither the Manager or its affiliates are prohibited by the Management Agreement or any other agreement with PERH or the Company from competing with PERH or the Company, or from acquiring, investing in, or providing administrative or managerial services to, a competitor of PERH or the Company. Accordingly, the Manager's and its affiliates' other business activities may result in conflicts.

To manage certain potential conflicts with respect to new and existing development opportunities and acquisition opportunities, the Company, EPCOR Power, EPCOR Operations, the Manager and Thomas Casten (former Chair and Chief Executive Officer of the Manager) are parties to an Allocation Agreement.

The Projects Depend on their Electricity and Thermal Energy Customers
Each Project relies for its revenues on one or more tolling agreement, lease agreement, or other agreement with its host. The amount of cash available for distribution to holders of EISs, Common Shares and Subordinated Notes is highly dependent upon customers under such agreements fulfilling their contractual obligations. There is no assurance that these customers will perform their obligations or make required payments on a timely basis. Each of the Projects is dependent upon its industrial host's continuing operations at those Projects, in that the revenue producing agreements with those hosts do not preclude a complete cessation of operations, whether due to unforeseen circumstances,

force majeure or the discretion of the host, which would also cease purchases of thermal or electric energy from the Projects, that would not necessarily result in an actionable breach of the Project's revenue producing contracts. Certain Projects rely on their industrial hosts for waste fuel and derive a significant portion of their revenue based on output rather than strictly on capacity payments; accordingly, these Projects rely on their industrial hosts to maintain industrial operations at a high level. Various conditions which are not within the control of the Company or the Project operators, and may not be within the control of the host industrial companies, may directly or indirectly result in significant reduction or cessation of industrial operations at any given Project, such as competitive pressures, mergers or acquisitions, adverse financial or economic conditions or events (including foreclosure, bankruptcy or liquidation of the industrial company), environmental constraints or incidents, weather conditions, labour actions, fuel shortages, equipment malfunction or refurbishment, accidents or sabotages, mismanagement, governmental action and force majeure. If any of the hosts were to materially curtail or cease manufacturing operations that require energy from a Project, a material portion of the Project's revenues could be interrupted or would cease, and there may be no contractual remedy or insurance coverage sufficient to cover such shortfalls. Moreover, substantial short or long-term changes in industrial operating levels short of material curtailment or cessation of operations can result from management decisions by the industrial hosts. These changes are not predictable, and such changes may produce material volatility in production-based revenues from any of the Projects so affected.

The Company has Limited Control Over the Harbor Coal Project

The Projects are wholly-owned, indirectly, by the Company, with the exception of the Harbor Coal Project. Harbor Coal LLC, an indirect subsidiary of Primary Energy, owns a 50% general partnership interest in PCI Associates which in turn owns the Harbor Coal Project. Harbor Coal LLC has limited control over the operation of the Harbor Coal Project. III/PCI, Inc., the other general partner of PCI Associates and an affiliate of Ispat Inland Inc., manages the operations of the Harbor Coal Project. Ispat Inland Inc. is an indirect subsidiary of Mittal Steel.

PERH's limited control results in a number of risks at the Harbor Coal Project. These include commodity costs such as coke, coal, natural gas, oil and oxygen costs, which can vary with market conditions; Mittal Steel determines which commodity mix is used on a daily basis. Furthermore, Mittal Steel determines the amount of hot metal produced per day for use in steel production. These factors determine the profitability of the Harbor Coal Project. PERH must also rely on the technical and management expertise of III/PCI, Inc. to oversee operations and maintenance of the Project. PERH is also reliant on accounting policies, procedures and financial reporting of Mittal Steel as they impact the accounting and financial reporting of PCI Associates. To the extent that III/PCI, Inc. does not fulfill its obligation to manage the operations of the Harbor Coal Project, or is not effective in doing so, the amount of cash available for distribution may be adversely affected.

Operations are Subject to the Provisions of Various Energy Laws and Regulations

The laws affecting our facilities have undergone major changes recently and, in some cases, remain in a state of flux pending completion of agency action and judicial review. The Energy Policy Act of 2005 ("EPAct 2005"), which was signed into law on August 8, 2005, added new criteria to the definition of a Qualifying Facility that must be satisfied by new Qualifying Facilities. The Company believes that the Recycled Energy Projects are not new Qualifying Facilities and that in any event they would satisfy the new criteria, but if this were not the case for any Recycled Energy Project, it could lose its Qualifying Facility status. This could subject such a Project to additional regulation under the Federal Power Act ("FPA") and/or state law.

In its rules implementing the EPAct 2005, the Federal Energy Regulatory Commission ("FERC") added a new requirement that Qualifying Facilities must certify as such with FERC. Existing Qualifying Facilities that were not already certified with FERC were given until April 17, 2006 to certify their status. The Recycled Energy Projects filed self-certifications with FERC on March 16, 2006 certifying their Qualifying Facility status.

EPAct 2005 also eliminated, subject to certain conditions to be determined by FERC and subject to the grandfathering of existing contracts, the requirement under the United States Public Utility Regulatory Policies Act of 1978, as amended, that electric utilities must purchase electric energy and capacity from, and sell electric energy and capacity to, Qualifying Facilities. FERC has issued a final rule to implement this change. While the Recycled Energy Projects do not currently sell power to or purchase power from electric utilities, these amendments may limit or eliminate their rights to compel such sales or purchases in the future.

EPAct 2005 also created a new FPA section 203(a)(2), which, if applicable to the Company, could require the Company under certain circumstances to obtain FERC approval before acquiring a Qualifying Facility or other electric utility company.

EPAct 2005 also repealed The Public Utility Holding Company Act of 1935, effective February 8, 2006, and abolished the utility ownership restrictions previously applicable to Qualifying Facilities. Finally, subject to certain exceptions and the grandfathering of existing contracts, FERC has revoked the exemptions from FPA sections 205 and 206 (rate regulation of utilities) previously afforded to Qualifying Facilities. To the extent the Recycled Energy Projects engage in wholesale power sales in the future, this revocation could subject them to some degree of rate regulation by FERC.

Timely and Accurate Reporting of Financial Results May Depend on the Ability of the Manager to Successfully Ensure that Internal Controls over Financial Reporting Function Properly

In connection with their audit of the consolidated financial statements for the period from August 24, 2005 to December 31, 2005, the Company's independent auditors reported a condition, relating to the proper and timely reporting of contracts and other agreements, that constituted a material weakness in internal control over the financial reporting that affected the Company's ability to produce and issue financial statements free from material misstatements on a timely basis. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. This control deficiency resulted in post closing year end adjustments to the Company's 2005 financial statements for the period from August 24, 2005 to December 31, 2005.

The Company has implemented controls and procedures such that this material weakness was alleviated as of December 31, 2006. These measures, along with existing controls cannot provide absolute assurance that the potential for misstatements will not exist. In addition, other deficiencies in the Company's internal controls over financial reporting may be identified in the future. The Company's development of internal controls over financial reporting continues to progress. Any failure to execute the effectiveness of controls in place or implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results, cause failure to meet reporting obligations on a timely basis or result in material misstatements in the annual or interim financial statements. Inadequate internal controls over financial reporting could also cause investors to lose confidence in the reported financial information, which could cause the stock price to decline.

The Company is Dependent on PERH and the Projects for All Cash Available for Distributions
The Company is dependent on the operations and assets of the Projects through its indirect ownership of the Projects. The Company's ability to make payments on the Subordinated Notes and to make cash distributions to holders of EISs and Common Shares will be dependent on the ability of PERH to make distributions to the Company, which in turn will be dependent on the ability of the Projects to make distributions to PERH. The actual amount of cash available for payments to holders of Subordinated Notes and distributions to holders of EISs and Common Shares will depend upon numerous factors relating to each of the Projects, including profitability, changes in revenues, fluctuations in working capital, capital expenditure levels, applicable laws, compliance with contracts and contractual restrictions contained in the instruments governing any indebtedness. Any reduction in the amount of cash available for distribution, or actually distributed, by the Projects or PERH will reduce the amount of cash available for the Company to make payments to holders of Subordinated Notes and distributions to holders of EISs and Common Shares. While the Company is contractually obligated to make interest payments on the Subordinated Notes, cash distributions by the Company on the Common Shares, including the Common Share component of an EIS, are not guaranteed and will fluctuate with the performance of the Projects.

Distribution of All or a Significant Amount of Available Cash May Restrict Potential Growth of PERH and the Company
The payout by the Company and PERH of substantially all of their operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of these funds could limit the future growth of the Company and PERH and their cash flow.

See the Company's Annual Information Form dated March 8, 2007, which can be found on SEDAR at www.sedar.com, for a full description of the Company's risk factors.

Recent Accounting Pronouncements
The Canadian Accounting Standards Board has recently issued new Handbook sections:

- 1530, Comprehensive Income;
- 3855, Financial Instruments – Recognition and Measurement; and
- 3865, Hedges.

Under these new standards, all financial assets should be measured at fair value with the exception of loans, receivables and investments that are intended to be held to maturity and certain equity investments, which should be measured at cost. Similarly, all financial liabilities should be measured at fair value when they are held for trading or they are derivatives. Gains and losses on financial instruments measured at fair value will be recognized in the income statement in the periods they arise with the exception of gains and losses arising from:

- Financial assets held for sale, for which unrealized gains and losses are deferred in other comprehensive income until sold or impaired; and
- Certain financial instruments that qualify for hedge accounting.

Sections 3855 and 3865 reference "other comprehensive income". Other comprehensive income comprises revenues, expenses, gains and losses that are excluded from net income. Unrealized gains and losses on qualifying hedging instruments, foreign currency, and unrealized gains or losses on financial instruments held for sale will be included in other comprehensive income and reclassified to net income when realized. Comprehensive income and its components will be required disclosure under the new standard.

The Company does not expect adoption of these standards as of January 1, 2007 to have a material impact on the consolidated financial statements.

Conditional Asset Retirement Obligations
In December 2005, the CICA Emerging Issues Committee issued Abstract No. 159, "Conditional Asset Retirement Obligations" (EIC–159). EIC-159 clarifies that the term conditional asset retirement obligation, as used in CICA Handbook Section 3110, "Asset Retirement Obligations" refers to a legal obligation to perform an asset retirement activity where the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. EIC-159 also clarifies when there would be sufficient information to reasonably estimate the fair value of an asset retirement obligation. EIC-159 is effective for interim and annual reporting periods ending after March 31, 2006. The adoption of EIC-159 did not have an impact on the Company's consolidated financial statements.

Capital Disclosures
In December 2006, the CICA released new Handbook Section 1535, Capital Disclosures, effective for interim and annual financial statements beginning on or after October 1, 2007. Section 1535 establishes standards for disclosing information about an entity's capital and how it is managed. It requires the disclosure of information about an entity's objectives, policies and processes for managing capital. The Company does not expect adoption of Section 1535 to have a material impact on the consolidated financial statements.

Financial Instruments – Disclosures and Presentation
In December 2006, the CICA released new Handbook Section 3862, Financial Instruments – Disclosures and Handbook Section 3863, Financial Instruments – Presentations effective for interim and annual financial statements beginning on or after October 1, 2007. Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity's financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset. The Company does not expect adoption of Section 3862 and Section 3863 to have a material impact on the consolidated financial statements.

Disclosure Controls and Procedures

Disclosure Controls and Procedures are controls and procedures designed and implemented by, or under the supervision of the Company's President, who performs similar functions to a Chief Executive Officer (the "President") and Chief Financial Officer ("CFO") to ensure that material information relating to the Company is communicated to management of the Company, including the President and CFO as it becomes known and is appropriately disclosed as required under the continuous disclosure requirements of applicable securities legislation. In essence, these types of controls are related to the quality and timeliness of disclosure of the Company's financial and non-financial information in securities filings.

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was conducted as of December 31, 2006, by and under the supervision of the Company's management, including the President and CFO. Based on this evaluation, the President and CFO have concluded that, the Company's disclosure controls and procedures, as defined in the Canadian Securities Administrators' Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings", are effective to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified by applicable securities legislation.

Internal Control over Financial Reporting

Internal control over financial reporting, designed by management, has the objective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian Generally Accepted Accounting Principles. For the financial reporting period from August 24, 2005 to December 31, 2005 a material weakness was noted related to the proper and timely reporting of contracts and other agreements. During 2006, management implemented internal control procedures that successfully alleviated the material weakness.

Additional Information

Additional information relating to the Company, including the audited consolidated financial statements for the year ended December 31, 2006 and for the period from August 24, 2005 to December 31, 2005 and the Company's Annual Information Form dated March 8, 2007, is available on SEDAR at www.sedar.com.