

MACQUARIE POWER INCOME FUND  
FINANCIAL REPORT  
FOR THE THREE AND EIGHT MONTHS ENDED  
DECEMBER 31, 2004



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Macquarie Power Income Fund (the "Fund") is not a trust company and is not registered under applicable legislation governing trust companies, as it does not carry on or intend to carry on the business of a trust company. The units are not "deposits" within the meaning of the Canada Deposit Insurance Corporation Act (Canada) and are not insured under the provisions of that act or any other legislation.

Macquarie Power Management Ltd. ("MPML") is the Manager of the Fund and is an indirect wholly-owned subsidiary of Macquarie Bank Limited, incorporated in Australia.

Investments in the Fund are not deposits with or other liabilities of Macquarie Bank Limited, or any entity in the Macquarie Bank Group and are subject to investment risk, including possible delays in repayment and loss of income and capital invested. Neither MPML, nor any member of the Macquarie Bank Group, guarantees the performance of the Fund, the repayment of capital or the payment of a particular rate of return on the Fund's units.

MPML, as the Manager of the Fund, is entitled to fees for so acting. Macquarie Bank Limited and its related corporations, together with their officers and directors may hold units in the Fund from time to time.

**Macquarie Power Income Fund**  
Management's Discussion and Analysis  
For the three months ended,  
December 31, 2004 (the "Quarter")  
and the eight months ended,  
December 31, 2004 (the "Period")

This report for the Macquarie Power Income Fund (the "Fund") summarizes the financial results for the quarter and period ended December 31, 2004. This discussion and analysis of the Fund's consolidated operating results, cash flow and financial position presented herein should be read in conjunction with the consolidated financial statements and related notes contained in this financial report, as well as the pro forma consolidated financial statements for the year ended December 31, 2003 and the consolidated financial forecast of the Fund for the year ended December 31, 2004 included in the prospectus of the Fund dated April 19, 2004.

All financial information has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). This report also contains figures that are not performance measurements according to GAAP. For instance, the Fund measures earnings before interest, taxes, depreciation and amortization and unrealized gains and losses ("EBITDA") because this method allows management to assess the operating and financial performance of the Fund's operations. Additional information in the section dealing with non-GAAP measurements compares EBITDA figures with the most comparable financial performance indicators.

The purpose of this discussion and analysis is to help the reader understand the financial performance of the Fund since its inception. Certain statements in this report may constitute "forward looking statements" and involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Fund to be materially different from any performance or achievement expressed or implied by such "forward looking statements".

#### **Consolidation and comparison of operating results**

The discussion and analysis of the operating results for the current period reflect the consolidated operations of the Fund, Macquarie Power Income Trust (the "Trust") and Cardinal Power of Canada L.P. ("Cardinal"). On the basis of revenue and EBITDA, the operating results for the consolidated entity are virtually identical to those of Cardinal as a stand-alone entity. As such, it is possible to compare the consolidated results of the Fund in the current period to the operating results of the Cardinal facility to the same period in the prior year.

The following discussion and analysis compares the actual results of the Fund for the quarter and period ended December 31, 2004 to the same periods of the previous year and to the forecast contained in the Fund's prospectus dated April 19, 2004. Since the period ended December 31, 2004 includes only eight months of activity, the actual data from the previous year and the forecast have been adjusted to reflect the results for the comparable interim period (the "FOFI"). In addition, the comparative numbers for 2003 have been restated to eliminate the impact of the levelization provisions contained in the power purchase agreement that impacted revenue and EBITDA in 2003. These provisions are no longer in effect as the levelization liability was totally repaid prior to listing on April 30, 2004 from the proceeds of the issue of the trust units.

#### **Accounting estimates**

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions (see Note 3 to the consolidated financial statements) that affect the reported amounts of assets and liabilities, disclosure of contingencies, and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

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## SELECTED CONSOLIDATED FINANCIAL AND OPERATING INFORMATION

The performance of the Fund for the quarter and period ended December 31, 2004 improved against the FOFI. The analysis that follows explains these improvements.

<i>(in millions of dollars, except per unit amounts)</i>	Quarter Ended			Period Ended		
	December 31, 2004	FOFI	December 31, 2003	December 31, 2004	FOFI	December 31, 2003
Revenue	24.3	24.3	20.5	55.8	55.2	48.3
EBITDA <sup>(i)</sup>	8.5	8.0	6.3	16.2	13.8	13.7
Depreciation and Amortization	3.1	3.1	(ii)	8.3	8.3	(ii)
Unrealized gain on gas swap Contracts	(0.2)	n/a	(ii)	(0.2)	n/a	(ii)
Financing expenses	0.3	0.5	(ii)	0.9	1.1	(ii)
Net income	5.3	4.4	(ii)	7.2	4.4	(ii)
<i>Per trust unit (\$)</i>	<i>0.249</i>	<i>0.209</i>	(ii)	<i>0.342</i>	<i>0.207</i>	(ii)
Cash flow from operations before changes to non- cash working capital items	8.6	7.5	(ii)	16.2	12.7	(ii)
Distributable cash <sup>(i)</sup>	7.9	7.0	(ii)	14.2	12.0	(ii)
<i>Per trust unit (\$)</i>	<i>0.371</i>	<i>0.343</i>	(ii)	<i>0.669</i>	<i>0.569</i>	(ii)
Distributions declared to Unitholders	5.0	n/a	(ii)	13.5	n/a	(ii)
<i>Per trust unit (\$)</i>	<i>0.238</i>	n/a	(ii)	<i>0.636</i>	n/a	(ii)
Payout ratio <sup>(iii)</sup>	64.2%	n/a	(ii)	95.0%	n/a	(ii)
Number of trust units outstanding (millions)	21.2	21.2	(ii)	21.2	21.2	(ii)
Sale of electricity (000s MWh)	336.0	339.2	287.2	842.5	837.3	736.7
Sale of steam (000s lbs)	181.2	178.9	182.7	440.3	452.0	455.3

<sup>(i)</sup> See "Additional information about non-GAAP performance measures" for a reconciliation of EBITDA and Distributable Cash to Net Income for the period. EBITDA and Distributable Cash are not recognized measures under GAAP and do not have a standardized meaning prescribed by GAAP. Therefore, EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers.

<sup>(ii)</sup> Financial results from the prior year have been presented only if comparable to the current year.

<sup>(iii)</sup> The payout ratio is defined as distributions declared as a proportion of distributable cash. Payout ratio is not a recognized measure under GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, it may not be comparable to similar measures presented by other issuers.

### Revenue

The Cardinal plant demonstrated high reliability with an availability of 97.9% and 98.0% for the quarter and period ended, respectively. Capacity load factors were 96.8% and 96.0% for the quarter and period ended, respectively and demonstrating the consistent output of the Cardinal plant.

For the quarter ended, the Fund generated revenue of \$24.3 million compared to \$20.5 million for the corresponding period in 2003. For the period ended, the Fund generated revenue of \$55.8 million compared to \$48.3 million for the corresponding period in 2003. These positive variances of \$3.8 million and \$7.5 million respectively are primarily due to higher volumes of electricity sold during the respective periods. Approximately 49,000 and 106,000 additional MWh were sold in the quarter and period ended, respectively, since curtailment of energy production was less than in 2003. In addition, the power rates in 2004 are higher than those of 2003, following increases in the Direct Customer Rate ("DCR") contained in Cardinal's power

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purchase agreement with the Ontario Electricity Financial Corporation (“OEFEC”). Steam sales accounted for \$ 0.2 million and \$ 0.6 of revenue for the quarter and period ended, respectively.

The actual revenue during the quarter was equal to the FOFI and during the period was \$0.6 million higher than the FOFI. These variances were mainly attributable to higher power rates than those contemplated at the time of the preparation of the FOFI.

## **EBITDA**

The total EBITDA generated by the Fund during the quarter and period ended was \$8.5 million and \$16.2 million respectively, an increase of \$2.2 million and \$2.5 million over the same periods in 2003. These positive variances arose from the additional revenue discussed above, offset by the direct costs associated with higher production volumes.

The EBITDA for the quarter and period ended were \$0.5 million and \$2.4 million higher than for the same periods in the FOFI. In addition to the increases in revenue explained above, EBITDA improvements for the period ended arose due to a reduction in gas transmission rates and differences caused by shifting preparatory work required for major maintenance activities in 2006. Preparatory work, which was originally scheduled for 2004, has been deferred to upcoming quarters in 2005. This will not affect the reliability and availability of the Plant nor the timing of major maintenance planned for 2005 and 2006. A reconciliation of Net Income to EBITDA is presented below in the section titled “Additional information about non-GAAP performance measures.”

## **Depreciation, amortization and Net Income**

Depreciation and amortization was equal to the FOFI at \$3.1 million for the quarter and \$8.3 million for the period. The Fund’s Net Income of \$5.3 million for the quarter and \$7.2 million for the period represent improvements of \$0.9 million and \$2.8 million respectively over those of the corresponding periods in the FOFI. The improvement is the result of revenue improvements and adjustments for the maintenance program differences discussed above.

## **Financing expenses**

Financing expenses amounted to \$0.3 million for the quarter and \$0.9 million for the period, both marginally lower than the FOFI. This decrease is due to reductions in borrowing costs as a result of steps taken to lock in interest rates with the lender.

During the period, the Fund converted its term loan from a prime rate loan to a series of Banker’s Acceptances (“BA”). The result of these transactions was to fix the interest rate on the Fund’s term loan for varying periods over the following 12 months. The all-in borrowing costs for the three BAs are fixed at 4.4% on \$11.7 million to March 13, 2005, 4.6% on \$11.6 million to June 13, 2005 and 4.5% on \$11.7 million to December 16, 2005. These transactions partially protect the Fund against increases in interest rates, with a view to adding to the stability and predictability of the Fund’s cash flows. The borrowing costs on these loans were paid at the inception date of the respective transactions and are amortized over the term of the respective maturities. The unamortized portion of the borrowing costs of \$0.8 million at December 31, 2004 is included in prepaid expenses and borrowing costs in the Consolidated Statement of Financial Position.

## **Unrealized gain on gas swap contracts**

At times, the Cardinal Plant does not produce electricity, such as in cases where the Plant is shut down in order to perform regularly scheduled maintenance. This will cause the Plant to have excess natural gas that it sells to mitigate the loss of revenue resulting from decreased electricity production. The sale of excess gas exposes the Fund to gas price volatility caused by fluctuations in the market rates for gas.

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To stabilize the cash flows from excess gas sales, Cardinal entered into 5-year gas swap contracts in April 2004. Under the terms of the contracts, Cardinal receives fixed payments from a counter-party, in exchange for paying floating payments to the counter-party that fluctuate based on the market prices of natural gas. The contracts are based on an estimated volume spread over the 7 month period from April until October. The contract volume can be adjusted to match the monthly profile of gas available for sale. The effect of the contracts is to fix the revenues Cardinal receives from the sale of excess gas. The contracts with the counter-party are a series of monthly contracts from April to October of each year and terminate October 31, 2008. This is an important benefit to the Fund because most of the revenue uncertainty with respect to the sale of excess gas has been removed.

A gain of \$0.2 million was recorded for the quarter and period ended December 31, 2004 to reflect the movement in fair value of certain of the contracts entered into for 2007 and 2008. This unrealized gain had no impact on the operating cash flows or distributable cash for the period ended.

### Cash flows

During the quarter, cash flow from operations before changes to non-cash working capital items totalled \$8.6 million as compared to \$7.5 million in the FOFI. For the period ended, this amount totalled \$16.2 million compared with \$12.7 million in the FOFI. These positive variances reflect the improved profitability of the Fund and a deferral of maintenance expenditures to 2005. Of the \$16.2 million in cash flow from operations before changes to non-cash working capital items generated during the period, \$11.8 million was distributed to Unitholders, \$1.7 million was used to pre-pay interest and effectively reduce interest rate volatility, and the balance was comprised primarily of changes to non-cash working capital.

### Liquid assets and financial position

As at December 31, 2004, cash and cash equivalents totalled \$10.9 million after net allocations for the period of \$1.5 million to the major maintenance reserve and \$0.3 million to the capital expenditure reserve. The breakdown of cash and cash equivalents at December 31, 2004 is as follows:

	(\$millions)
Major maintenance reserve	4.3
Capital expenditure reserve	0.9
General reserve	3.0
Other cash and cash equivalents	2.7
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Cash and cash equivalents	10.9
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The Fund also has a \$15 million revolving operating loan available. Currently there is no amount outstanding on the facility.

Long-term assets and liabilities were stable during the period. As at December 31, 2004, Unitholders' Equity was \$188.7 million, reflecting a small increase during the quarter due to the positive difference between Net Income and distributions to Unitholders declared to date. Long-term debt totalled \$35.0 million or a ratio of debt to Unitholders' equity of 0.19:1.00.

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## Additional information about non-GAAP performance measures

### EBITDA

To assess the operating performance of its assets, the Fund uses EBITDA, even though it is not a performance measurement under GAAP. EBITDA is a widely accepted financial indicator used by investors to assess the performance of a company or a Fund, and its ability to generate cash through operations. Management believes that this is especially relevant for the Fund, which pays out virtually all of its cash flow in regular distributions. However, since EBITDA is not a measurement of performance under GAAP, it may not be comparable to similarly named measures used by other companies. Investors should not use EBITDA as an alternative for Net Income, an indicator of operating results or cash flows, or a parameter for measuring liquidity.

The following table reconciles EBITDA to Net Income:

	Quarter Ended December 31, 2004 (\$millions)	Period Ended December 31, 2004 (\$millions)
Net income	5.3	7.2
Net interest expense	0.3	0.9
Depreciation and amortization	3.1	8.3
Unrealized gain on gas swap contracts	(0.2)	(0.2)
EBITDA	8.5	16.2

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### *Distributable Cash*

Distributable Cash and payout ratio are not recognized performance measurements under GAAP. Canadian open-ended trusts, such as the Fund, use distributable cash and payout ratios as indicators of financial performance. Distributable Cash and payout ratio may differ from similar computations as reported by other entities and, accordingly, may not be comparable to distributable cash and payout ratios as reported by such entities. Management believes that Distributable Cash and payout ratio are useful supplemental measures that may assist investors in assessing financial performance.

The following is a reconciliation of distributable cash:

	Quarter Ended December 31, 2004 (\$millions)	Period Ended December 31, 2004 (\$millions)
Net income for the period	5.3	7.2
Add:		
Depreciation and amortization and non-cash accretion of interest on decommissioning liability	3.1	8.4
Release from major maintenance reserve account	0.1	0.2
Release from capital expenditure reserve account	0.3	0.4
Less:		
Unrealized gain on gas swap contracts	(0.2)	(0.2)
Allocation to major maintenance expenditure reserve account	(0.6)	(1.5)
Allocation to capital expenditure reserve account	(0.1)	(0.3)
Distributable cash for the period	<u>7.9</u>	<u>14.2</u>
Distributable cash per unit for the period (\$)	<u>0.371</u>	<u>0.669</u>

The Fund declared distributions to Unitholders of \$13.5 million for the Period. This represents a payout ratio of 95.0% for the Period (payout ratio is defined as distributions declared as a proportion of distributable cash).

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## GENERAL ITEMS

### Seasonality

Since the Fund's power station has long-term power sales and gas purchase contracts with fixed prices, its results are not significantly affected by fluctuations resulting from the market prices for electricity or the volatility in the price of natural gas. However, the power sales contracts contain lower power rates during the six-month period from April to September (and higher prices from October to March) to reflect differences in market demand between these two different segments of the year. In addition, the power station generally performs its major maintenance during the April to September period, and as a result, the Fund's operating performance during this period is somewhat below that of the remainder of the year. To partially offset this seasonality, the power station sells the excess gas not consumed at prevailing market prices through a gas resale agreement with its gas supplier. In addition, a cash balance of \$2.0 million was included in the assets of Cardinal LP acquired by the Fund. This cash balance is intended to offset the seasonality in electricity demand and is expected to be sufficient to maintain level monthly distributions to Unitholders throughout the coming years.

### Related party transactions

During the quarter, the Fund incurred management fees and administrative fees to Macquarie Power Management Ltd ("MPML") of \$144,832 and \$25,188, respectively. For the period ended, the Fund incurred management fees and administrative fees of \$387,269 and \$67,351 to MPML, respectively. Also, during the quarter and period ended, the Fund recorded additional cost reimbursements of \$189,199 and an incentive fee of \$203,752 to MPML. These fees have been approved by the Board of Trustees of the Fund and conform to the terms of the Management and Administration agreements in place.

### Trust units on issue

At December 31, 2004, the Fund had 21.2 million trust units outstanding. There were no changes to trust units outstanding during the quarter or the period.

### Contractual obligations and other commitments

There were no significant changes in the Fund's obligations and commitments since April 19, 2004, the date of the Fund's prospectus.

### Risks and uncertainties

Management is of the opinion that there have been no significant changes in risks and uncertainties since April 19, 2004. Please refer to Risk Factors in the Fund's prospectus dated April 19, 2004.

### Assessment of 2004 and outlook for 2005

The Fund exceeded the FOPI primarily due to improvements in electricity prices, a reduction in gas transmission rates and a shift in preparatory maintenance work from 2004 to 2005. In the period since listing in April 2004, the Fund has established a firm foundation for the future with the introduction of a comprehensive suite of corporate governance policies and procedures, financial reporting and control procedures, financial systems and a business plan for future growth. Cardinal Power, the Fund's asset, has been operated and maintained to provide for stable and reliable performance in keeping with the requirements of the Fund.

In 2005, the Fund will continue to focus on identifying profitable investment opportunities to diversify its risk profile and enhance cash available for distributions to unitholders.

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Macquarie Power Income Fund  
Consolidated Statements of Financial Position  
(Unaudited)

	December 31, 2004 (\$000s)	September 30, 2004 (\$000s)
<b>Current Assets</b>		
Cash and cash equivalents (note 4)	10,883	9,973
Accounts receivable	8,753	5,926
Inventory	88	82
Prepaid expenses and borrowing costs	1,223	1,402
<b>Total Current Assets</b>	<b>20,947</b>	<b>17,383</b>
Property, plant and equipment (note 5)	148,240	149,919
Electricity supply and gas purchase contracts (note 5)	44,786	45,992
Gas swap contracts at fair value (note 13)	213	-
Goodwill (note 2)	18,023	18,023
<b>Total Assets</b>	<b>232,209</b>	<b>231,317</b>
<b>Current Liabilities</b>		
Trade payables and accrued expenses	6,336	5,707
Distributions payable	1,676	1,676
<b>Total Current Liabilities</b>	<b>8,012</b>	<b>7,383</b>
Long term debt (note 7)	35,000	35,000
Liability for asset retirement	517	508
<b>Total Liabilities</b>	<b>43,529</b>	<b>42,891</b>
<b>Unitholders' Equity</b>	<b>188,680</b>	<b>188,426</b>
<b>Total Unitholders' Equity and Liabilities</b>	<b>232,209</b>	<b>231,317</b>

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Macquarie Power Income Fund  
Consolidated Statement of Unitholders' Equity  
(Unaudited)

	Cumulative Unitholders' Equity (\$000s)	Retained Earnings (\$000s)	Cumulative Distributions (\$000s)	Total (\$000s)
<b>Opening balance at April 30, 2004</b>	-	-	-	-
Units issued as part of the Initial Public Offering on April 30, 2004	211,690	-	-	211,690
Costs incurred in relation to the Initial Public Offering	(17,248)	-	-	(17,248)
Unitholders' capital immediately after the Initial Public Offering	194,442	-	-	194,442
Net income for the period April 30 to June 30, 2004	-	1,078	-	1,078
Distributions declared to Unitholders for the period April 30 to June 30, 2004 (note 10)	-	-	(3,407)	(3,407)
<b>Closing balance at June 30, 2004</b>	194,442	1,078	(3,407)	192,113
Revision to estimate of costs incurred in relation to the Initial Public Offering	465	-	-	465
Net income for the quarter ended September 30, 2004	-	876	-	876
Distributions declared to Unitholders for the quarter ended September 30, 2004 (note 10)	-	-	(5,028)	(5,028)
<b>Closing balance at September 30, 2004</b>	194,907	1,954	(8,435)	188,426
Net income for the quarter ended December 31, 2004	-	5,282	-	5,282
Distributions declared to Unitholders for the quarter ended December 31, 2004 (note 10)	-	-	(5,028)	(5,028)
<b>Closing balance at December 31, 2004</b>	194,907	7,236	(13,463)	188,680

Information for the comparative reporting period to December 31, 2003 has not been provided as the Fund had not been formed at that time. The financial statements should be read in conjunction with the accompanying notes included in this financial report.

Macquarie Power Income Fund  
Consolidated Statements of Income  
(Unaudited)

	Quarter Ended December 31, 2004 (\$000s)	Period Ended December 31, 2004 (\$000s)
Revenue	24,256	55,848
Cost and expenses		
Operating costs	15,038	38,382
Administrative expenses	686	1,162
Depreciation and amortization	3,131	8,340
	18,855	47,884
Income from operations	5,401	7,964
Unrealized gain on gas swap contracts (note 13)	213	213
Net interest expense	(332)	(941)
<b>Net income for the period</b>	<b>5,282</b>	<b>7,236</b>
Weighted average number of trust units outstanding (units)	21,168,997	21,168,997
Basic and diluted earnings per trust unit (\$)	0.249	0.342

*Information for the comparative reporting period to December 31, 2003 has not been provided as the Fund had not been formed at that time. The financial statements should be read in conjunction with the accompanying notes included in this financial report.*

Macquarie Power Income Fund  
Consolidated Statements of Cash Flow  
(Unaudited)

	Quarter Ended December 31, 2004 (\$000s)	Period Ended December 31, 2004 (\$000s)
Cash flows from operating activities:		
Net income	5,282	7,236
Add back:		
Movement of fair value of gas swap contracts (note 13)	(213)	(213)
Depreciation and amortization	3,131	8,340
Amortization of prepaid borrowing costs	382	824
Accretion of asset retirement liability	9	36
Non-cash changes in working capital		
Decrease in trade receivables	(2,827)	(2,039)
Decrease (increase) in inventory	(6)	48
Decrease (increase) in prepaid expenses	318	(360)
Increase in trade payables	629	857
<b>Total cash flows from operating activities</b>	<b>6,705</b>	<b>14,729</b>
Cash flows from investing activities:		
Cash paid in relation to the acquisition of Cardinal Power of Canada, L.P. net of cash acquired	-	(219,943)
Investment in fixed assets	(246)	(366)
<b>Total cash flows from investing activities</b>	<b>(246)</b>	<b>(220,309)</b>
Cash flows from financing activities:		
Cash proceeds received from the Initial Public Offering	-	211,690
Costs paid in relation to the Initial Public Offering	-	(16,783)
Cash proceeds received from the issue of the Term Loan	-	35,000
Prepayment of borrowing costs and interest	(521)	(1,657)
Distributions paid to Unitholders	(5,028)	(11,787)
<b>Total cash flows from financing activities</b>	<b>(5,549)</b>	<b>216,463</b>
<b>Net increase in cash and cash equivalents</b>	<b>910</b>	<b>10,883</b>
Cash and cash equivalents at the beginning of period	9,973	-
<b>Cash and cash equivalents at the end of period</b>	<b>10,883</b>	<b>10,883</b>

*Information for the comparative reporting period to December 31, 2003 has not been provided as the Fund had not been formed at that time. The financial statements should be read in conjunction with the accompanying notes included in this financial report.*

Macquarie Power Income Fund  
Notes to the Consolidated Financial Statements  
December 31, 2004 Quarterly Financial Report  
(Unaudited)

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1. Organization

The Fund is an unincorporated open-ended trust established on March 15, 2004, under the laws of the Province of Ontario. The Fund issued two initial units on March 15, 2004 for cash proceeds of \$20. An unlimited number of units may be issued pursuant to the trust indenture. The Fund began its operations on April 30, 2004 and indirectly acquired 100% of the equity of Cardinal. Cardinal is a 156-megawatt, gas-fired combined cycle cogeneration plant located in Cardinal, Ontario.

MPML, a 100% subsidiary company of Macquarie North America Ltd., provides administrative services to the Fund, in accordance with an administration agreement, and management services to Cardinal, in accordance with a management agreement.

Pursuant to an underwriting agreement dated April 19, 2004, the Fund issued 21.2 million units at a price of \$10 each, for gross proceeds of \$211.7 million. The Fund also redeemed the two initial units issued on March 15, 2004 at their original issue price. After paying the Initial Public Offering ("IPO") costs of \$16.8 million, the net proceeds of \$194.9 million from the issue of units and \$35.0 million from the issue of the term loan were used to acquire 100% of the equity of Cardinal.

2. Business combinations

The acquisition of Cardinal has been accounted for using the purchase method. The total purchase price of \$229.9 million has been provisionally allocated to the assets and liabilities of Cardinal as follows:

	(\$000s)
<b>Assets</b>	
Cash and cash equivalents	9,964
Accounts receivable	6,714
Inventory	136
Prepaid expenses	30
<b>Total Current Assets</b>	<u>16,844</u>
Property, plant and equipment	153,000
Contracts	48,000
Goodwill	18,023
<b>Total Assets</b>	<u>235,867</u>
<b>Liabilities</b>	
Trade payables and accrued expenses	<u>(5,479)</u>
<b>Total Current Liabilities</b>	<u>(5,479)</u>
Liability for asset retirement	<u>(481)</u>
<b>Total Liabilities</b>	<u>(5,960)</u>
<b>Total Purchase Price</b>	229,907
Less: Cash acquired	<u>(9,964)</u>
<b>Amount Paid Net of Cash Acquired</b>	<u>219,943</u>

### 3. Significant accounting policies

The following is a summary of the significant accounting policies followed by the Fund.

#### *Use of estimates*

The financial information contained in the accompanying financial statements has been prepared in accordance with GAAP, which require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses during the reporting period. Actual results could differ from the estimates and the difference could be significant. Management estimates are used primarily in two areas: sales volumes are estimated to record accruals of revenue receivable in the last month of a reporting period; and natural gas volumes are estimated to record accruals of gas consumption and transportation costs in the last month of a reporting period. Also, sales of electricity are based on provisional power rates communicated by the OEFC. The agreement with OEFC provides that the provisional rates are used to settle electricity delivered from the plant during the year and finalized by OEFC subsequent to each fiscal year.

#### *Basis of presentation*

In addition to the Fund, these consolidated financial statements include the assets and liabilities and results of operations of the Trust, Cardinal Power Inc. (the "General Partner") and Cardinal, all of which are 100% owned subsidiaries of the Fund. All intercompany balances and transactions have been eliminated.

#### *Contracts*

Electricity supply and gas purchase contracts are separately identifiable intangible assets. The assets are presented in the Statement of Financial Position, and are recorded at their fair value at the date of acquisition. The contracts are amortized over their useful life of 10 years using the straight-line method.

#### *Property, plant and equipment*

Property, plant and equipment have been recognized at cost of acquisition and are included in the Statement of Financial Position as part of Capital assets. Plant and equipment is depreciated over its useful life of 20 years using the straight-line method.

#### *Goodwill*

Goodwill is recorded at cost and is tested for impairment in the first quarter of each fiscal year or when indications of impairment arise. An impairment loss is recognized when the fair value of goodwill is less than its carrying amount.

#### *Impairment of assets*

The Fund evaluates the operating and financial performance of its long-lived assets for potential impairment in accordance with CICA Accounting Recommendation 3063 "Impairment of long-lived assets." If an asset is determined to be impaired, the asset is written down to its fair value. The Fund reviews the fair value of long-lived assets in the first quarter of each fiscal year or as indicators of impairment arise.

#### *Derivative instruments*

The Fund uses swap contracts to manage its exposure to price fluctuations on sales of excess gas volumes.

The Fund has adopted Accounting Guideline 13, Hedging Relationships ("AcG 13") issued by the Canadian Institute of Chartered Accountants, which establishes the criteria for applying hedge accounting for derivative instruments. Derivatives that have been designated and function effectively as hedges in accordance with AcG-13, are accounted for using hedge accounting principles. These require that the current period income or expense generated by the contracts be recognized during the period in which the underlying hedged transactions occur as adjustments to operating expenses.

Derivatives that do not qualify for hedge accounting are recorded in the Statement of Financial Position at fair value. Changes in fair value recorded in Net Income are reflected in the statement of income.

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*Revenue recognition*

Revenue from the sale of electricity and steam is recognized when delivered to the customer and priced in accordance with the provisions of the applicable power and steam sales agreements.

*Maintenance and repairs*

Routine maintenance, repairs and major overhaul costs are charged to the income statement in the period they are incurred.

*Income taxes*

Under the terms of the Income Tax Act (Canada) (the "Tax Act"), Cardinal LP, as a partnership, is not subject to income taxes. Its income will be allocated to and included in computing the income of its partners, who are the General Partner and the Trust. Under the terms of the Tax Act, the Fund and the Trust are not generally subject to income tax to the extent their taxable income and taxable capital gains are distributed to Unitholders. As the Fund and the Trust are contractually committed to distribute all or virtually all of their taxable income and taxable capital gains to Unitholders, it is not likely that either entity will be subject to income taxes. Accordingly, no provision for income taxes has been recorded in the Fund or the Trust.

*Net Income per Unit*

Net Income per Unit is established by dividing Net Income, as determined above, by the Weighted Average Number of Units Outstanding during the period.

**4. Cash and cash equivalents**

Cash and cash equivalents comprise highly liquid investments with original maturities of less than 90 days. At December 31, 2004, cash and cash equivalents included the following:

	<u>(\$000s)</u>
Major maintenance reserve	4,334
Capital expenditure reserve	897
General reserve	<u>3,000</u>
Total reserve accounts	8,231
Other cash and cash equivalents	<u>2,652</u>
Cash and cash equivalents	<u>10,883</u>



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5. Property, plant and equipment and electricity supply and gas purchase contracts

	Property, Plant and Equipment (\$000s)	Electricity supply & gas purchase contracts (\$000s)
Acquisition cost	153,000	48,000
Depreciation for the two months ended, June 30, 2004	(1,275)	(800)
Balance at June 30, 2004	151,725	47,200
Depreciation for the quarter ended, September 30, 2004	(1,926)	(1,208)
Purchases of fixed assets during the quarter	120	-
Balance at September 30, 2004	149,919	45,992
Depreciation for the quarter ended, December 31, 2004	(1,925)	(1,206)
Purchases of fixed assets during the quarter	246	-
<b>Total</b>	<b>148,240</b>	<b>44,786</b>

6. Bank credit facility

The Bank credit facility is a 364-day revolving operating loan for an amount of \$15 million. At maturity, April 30, 2005, the loan can be replaced by a loan with similar terms and conditions and for successive periods of 364 days. Collateral for the facility is provided by a first ranking hypothec covering the assets of Cardinal. The utilization of the facility is subject to certain financial and non-financial covenants. Advances under the facility are made in the form of BAs or Prime Rate loans. In the case of BAs, interest is charged at the BA rate plus a stamping fee based on the Fund's ratio of consolidated total debt to consolidated EBITDA. In the case of Prime Rate loans, interest is charged at the bank's Prime Rate plus an applicable margin based on the same ratio. As at December 31, 2004, no amount is outstanding under the facility.

7. Long-term debt facility

The long-term debt facility is a 3-year term loan for an amount of \$35 million maturing April 29, 2007. Collateral for the facility is provided by a first ranking hypothec covering the assets of Cardinal. Utilization of the facility is subject to certain financial and non-financial covenants. Advances under the facility are made in the form of BAs or Prime Rate loans. In the case of BAs, interest is charged at the BA rate plus a stamping fee based on the Fund's ratio of consolidated total debt to consolidated EBITDA. In the case of Prime Rate loans, interest is charged at the bank's Prime Rate plus an applicable margin based on the same ratio. At December 31, 2004, the Fund's long-term debt was in the form of a series of BA loans as follows:

Draw down amount (\$000s)	Maturity	All-in Rate
\$11,700	March 13, 2005	4.4%
\$11,600	June 13, 2005	4.6%
\$11,700	December 16, 2005	4.5%

Borrowing costs, including interest, are paid at the inception of each BA loan. These costs are capitalized and amortized over the life of each respective loan. During 2004, the Fund prepaid \$1,657 in borrowing costs. As at December 31, 2004, the unamortized portion of the capitalized borrowing costs totaled \$833 and is included in the Statement of Financial Position.

## 8. Units issued by the Fund

An unlimited number of units may be issued by the Fund pursuant to the Fund trust indenture. Each unit is transferable and represents a Unitholder's proportionate undivided beneficial ownership interest in any distributions from the Fund, including distributions of Net Income, net realized capital gains or other amounts. Each unit also entitles the Unitholder to share in the net assets of the Fund in the event of termination or winding-up. All units have equal rights and privileges. The units are not subject to future calls or assessments and entitle the Unitholder to one vote for each unit held at all meetings of Unitholders. Units do not have conversion, retraction or pre-emptive rights, and are redeemable at any time on demand by Unitholders at an amount equal to the lesser of:

- (i) 90% of the daily weighted average price per unit during the period of the last 10 days; and
- (ii) an amount equal to either:
  - (a) the closing price of the units on the date on which the units were tendered for redemption;
  - (b) the average of the highest and lowest prices of units on the date on which the units were tendered for redemption; or
  - (c) the average of the last bid and ask prices on the date on which the units were tendered for redemption.

The total amount payable in cash by the Fund in respect of such units and all other units tendered for redemption in the same calendar month shall not exceed \$50,000 (provided that such limitation may be waived at the discretion of the trustees of the Fund). In total, 21.2 million units have been issued as at December 31, 2004.

## 9. Distributable cash

The amount of cash distributed monthly is based on 100% of the Net Income of the Fund adjusted for non-cash transactions including depreciation and amortization and allocations to the reserve accounts. The distributable cash also takes into account additions to property, plant and equipment, and any other amount that the Trustees reasonably consider to be necessary to provide for the payment of any costs or expenses for the operation of the Fund and for reasonable reserves.

The following is a reconciliation of distributable cash for the quarter and period ended:

	Quarter Ended December 31, 2004 (\$000s)	Year Ended December 31, 2004 (\$000s)
Net income for the period	5,282	7,236
Add:		
Depreciation and amortization	3,131	8,340
Non-cash accretion of interest on decommissioning liability	9	36
Release from major maintenance reserve account	85	215
Release from capital expenditure reserve account	246	366
Less:		
Movement of fair value of gas swap contracts	(213)	(213)
Allocation to major maintenance reserve account	(581)	(1,549)
Allocation to capital expenditure reserve account	(99)	(263)
	<hr/>	<hr/>
Distributable cash for the period	7,860	14,168
	<hr/>	<hr/>
Distributable cash per unit for the period (\$)	0.371	0.669

## 10. Distributions to Unitholders

Distributions to Unitholders are paid on the last day of each month, one month in arrears. The following distributions have been declared to Unitholders for the period ended December 31, 2004:

Period of distribution	Date of payment	Amount declared (\$000s)	Amount declared (\$ per unit)
April 30 to May 31, 2004	June 30, 2004	1,731	0.08177
June 1 to June 30, 2004	July 31, 2004	1,676	0.07917
Two months ended June 30, 2004		3,407	0.16094
July 1 to 31, 2004	August 31, 2004	1,676	0.07917
August 1 to 31, 2004	September 30, 2004	1,676	0.07917
September 1 to 30, 2004	October 31, 2004	1,676	0.07917
Quarter ended September 30, 2004		5,028	0.23751
October 1 to 31, 2004	November 30, 2004	1,676	0.07917
November 1 to 30, 2004	December 31, 2004	1,676	0.07917
December 1 to 31, 2004	January 31, 2005	1,676	0.07917
Quarter ended December 31, 2004		5,028	0.23751
Period ended December 31, 2004		13,463	0.63596

Any income of the Fund that is applied to cash redemptions of units or is otherwise unavailable for cash distribution will be distributed to Unitholders in the form of additional units. Such additional units will be issued pursuant to applicable exemptions under applicable securities laws, discretionary exemptions granted by applicable securities regulatory authorities or a prospectus or similar filing.

## 11. Related party transactions

MPML provides management services to Cardinal under a 20-year management agreement. A fee of \$575,000 per annum is payable by Cardinal to MPML for the provision of these services, adjusted annually in line with the Consumer Price Index. MPML is entitled to seek reimbursement for all costs and expenses incurred in carrying out its management services. MPML may also earn an annual incentive fee equal to 25% of the amount by which the distributable cash per unit in a calendar year exceeds \$0.95 multiplied by the weighted average number of units of the Fund outstanding for the relevant fiscal year or part thereof.

Pursuant to a 20-year administration agreement, MPML provides the Fund and the Trust with certain administrative and support services. MPML receives an annual fee of \$100,000 for these services and is entitled to be reimbursed for all reasonable costs and expenses incurred in carrying out such services as approved by the independent Trustees.

During the quarter, the Fund incurred management fees and administrative fees to MPML of \$144,832 and \$25,188 respectively. For the period ended, the Fund incurred management fees and administrative fees of \$387,269 and \$67,351 to MPML, respectively. During the quarter and period ended, the Fund recorded additional cost reimbursements of \$189,199 and an incentive fee of \$203,752.

## 12. Commitments and Contingencies

### *Power purchase agreement*

Cardinal has entered into an agreement to sell all electricity produced at its Facility, less the amount of electricity consumed in the operation of the Facility, to the OEFC until December 31, 2014.

### *Fuel supply contracts*

Cardinal has entered into long-term purchase agreements for natural gas and gas transportation that expire on May 1, 2015 and October 31, 2014, respectively. Minimum commitments under such agreements are 9,289,104 MMBtu per year through to expiration in 2015. Under its long-term purchase agreement for natural gas, Cardinal is required to purchase a minimum volume of gas equivalent to 80% of the contract maximum, or the supplier is entitled to financial compensation from Cardinal.

### *Gas swap contracts*

Cardinal has entered into gas swap contracts to hedge itself against fluctuations in the price of excess gas sold under the gas mitigation clause of the gas purchase agreement. The gas swap contracts require Cardinal to pay variable payments to the counter-party based on 436,814 MMBtu of gas at the market rate of natural gas in exchange for receiving fixed payments based on 436,814 MMBtu of gas at a fixed price per MMBtu for up to five years ending October 31, 2008. The contracts cover the sale of gas for the seven-month period from April to October. As at December 31, 2004, there were four years of contracts remaining.

### *Lease*

Cardinal leases a portion of the site on which the facility is located from Canada Starch Operating Company Inc. ("CASCO"). Under the lease, Cardinal pays nominal rent. The lease expires concurrently with the energy savings agreement between CASCO and Cardinal. The energy savings agreement currently expires on January 31, 2015 but can be extended by mutual agreement.

### *Environmental Commitments*

Under regulations recently issued by the Ontario Ministry of Environment ("MOE"), Cardinal was required to install at its facility either Continuous Emission Monitors ("CEMS") or MOE Director-approved Predictive Emissions Monitors ("PEMS"). During the period, Cardinal decided to implement a CEMS system, and the estimated capital cost of implementing the system is not expected to exceed \$250,000. To date, \$199,070 has been incurred and has been funded from the capital expenditure reserve account. The system implementation was completed and certified by January 21, 2005.

In relation to the requirement to implement emission monitoring, there was a period of 68 days during the calendar year 2004 that Cardinal did not comply with certain MOE requirements. Fines and penalties may be exigible. However, in the opinion of management, it is unlikely that the financial impact would be material.

### 13. Financial Instruments

Financial instruments consist primarily of temporary cash investments, trade receivables, current liabilities and gas swap contracts. The fair value of the Fund's financial instruments included in current assets and current liabilities approximate the carrying amount due to their short-term maturities.

The Fund invests its cash balances in financial instruments of highly rated financial institutions and government securities. A substantial portion of its trade receivables are from a major electric utility and the associated credit risks are deemed to be limited.

The fair value of the Fund's long-term debt changes as interest rates change. The fair value of this debt approximates the carrying value due to the fact that the amounts advanced under the facility were made recently (refer to note 7).

The Fund has entered into gas swap contracts to fix the revenue derived from the sale of excess gas (refer to note 12). Two of these contracts meet the effectiveness criteria for hedge accounting and accordingly, the fair value of these contracts has not been reflected in the financial statements. The fair value of these derivatives at December 31, 2004 is estimated to be a liability to the Fund of \$652,000. However, the Fund intends to hold these contracts to maturity to mitigate exposure to gas price fluctuations from sales of excess gas volumes in 2005 and 2006.

There are two other gas swap contracts that do not meet the effectiveness criteria for hedge accounting and accordingly, the fair value of these contracts has been included in the Statement of Financial Position with a corresponding unrealized gain recorded in the Statement of Income. The fair value of these derivatives at December 31, 2004 is estimated to be an asset to the Fund of \$213,000. The Fund intends to hold these contracts to maturity to mitigate exposure to gas price fluctuations from sales of excess gas volumes in 2007 and 2008.

### 14. Economic dependence

For the period ended, approximately 98.8% of the Fund's revenue was derived from the sale of electricity to Ontario Electricity Financial Corporation ("OEFC"). Approximately 97.0% of the December 31, 2004 accounts receivable balance was due from OEFC relating to electricity sales.

For the period ended, approximately 94.8% of the Fund's cost of goods sold derived from the purchase of gas from Husky Energy Marketing Inc. ("Husky") under a long-term gas purchase contract. Approximately 74.8% of the December 31, 2004 trade payables and accrued expenses was payable to Husky relating to gas purchases.

## ADDITIONAL INFORMATION

Additional information about the Fund, including the prospectus, dated April 19, 2004, is published on the SEDAR website ([www.sedar.com](http://www.sedar.com)) and the Macquarie Power Income Fund website ([www.macquarie.com/mpt](http://www.macquarie.com/mpt)).

## INVESTOR INFORMATION

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EXCHANGE LISTING:  
Macquarie Power Income Fund's units are listed on the Toronto Stock Exchange and trade under the symbol MPT.UN