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**Our second quarter interim
financial report 2000**



HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2000	1999	2000	1999
Revenues				
Transmission	319	300	641	605
Distribution (including retail)	360	402	866	920
Other	–	28	–	55
	679	730	1,507	1,580
Costs				
Operation, maintenance and administration	179	180	383	374
Purchased power	175	207	436	484
Depreciation and amortization	81	86	163	161
Transitional cost adjustment	–	–	–	55
Provincial debt guarantee fee	–	–	–	8
	435	473	982	1,082
Income before financing charges and provision for payments in lieu of corporate income taxes	244	257	525	498
Financing charges	84	86	166	217
Income before provision for payments in lieu of corporate income taxes	160	171	359	281
Provision for payments in lieu of corporate income taxes	42	80	115	80
Net income	118	91	244	201

See accompanying notes to the consolidated financial statements

**HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS**

(Canadian dollars in millions)	June 30, 2000	December 31, 1999
	(unaudited)	
Assets		
Current assets		
Cash and temporary investments	305	468
Accounts receivable (net)	480	536
Materials and supplies	84	81
	869	1,085
Fixed assets		
Fixed assets in service	12,031	11,907
Less: accumulated depreciation	3,974	3,848
	8,057	8,059
Construction in progress	406	300
	8,463	8,359
Other long-term assets		
Other post-retirement and post-employment benefits asset	356	377
Long-term accounts receivable and other assets	37	28
Deferred debt cost	12	-
Deferred pension asset (<i>Note 3</i>)	452	241
	857	646
Total assets	10,189	10,090

See accompanying notes to the consolidated financial statements

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS (continued)

(Canadian dollars in millions)	June 30, 2000 (unaudited)	December 31, 1999
Liabilities		
Current liabilities		
Accounts payable and accrued charges	229	403
Accrued interest	74	72
Long-term debt payable within one year <i>(Note 4)</i>	479	1,399
	782	1,874
Long-term debt <i>(Note 4)</i>	4,412	3,446
Other long-term liabilities		
Other post-retirement and post-employment benefits	475	453
Long-term accounts payable and accrued charges	55	52
Regulatory liability <i>(Note 3)</i>	452	241
	982	746
Total liabilities	6,176	6,066
Shareholder's equity <i>(Note 2)</i>	4,013	4,024
Total liabilities and shareholder's equity	10,189	10,090

See accompanying notes to the consolidated financial statements

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY (unaudited)

(Canadian dollars in millions)	2000
Shareholder's equity, January 1	4,024
Net income, three months ended March 31	126
Issuance of share capital, March 31 <i>(Note 2)</i>	
Preferred shares, 5.5% cumulative (authorized: unlimited; issued: 12,920,000 shares)	323
Common shares (authorized: unlimited; issued: 100,000 shares)	3,436
Shares to be issued	(3,759)
Dividends <i>(Note 2)</i>	(171)
Shareholder's equity, March 31	<u>3,979</u>
Net income, three months ended June 30	118
Dividends <i>(Note 2)</i>	(84)
Shareholder's equity, June 30	<u><u>4,013</u></u>
(Canadian dollars in millions)	1999
Excess of assets over liabilities of the Acquired Businesses, January 1	2,431
Net income, three months ended March 31	110
Net refunds on annexation by municipalities	(25)
Net excess of assets over liabilities of the Acquired Businesses, March 31	<u>2,516</u>
Capitalization of Hydro One Inc., April 1 <i>(Note 2)</i>	
Shares to be issued:	
Preferred shares, 5.5% cumulative (authorized: unlimited; to be issued: 12,920,000 shares)	323
Common shares (authorized: unlimited; to be issued: 100,000 shares)	3,436
	<u>3,759</u>
Net income, three months ended June 30	91
Shareholder's equity, June 30	<u><u>3,850</u></u>

See accompanying notes to the consolidated financial statements

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2000	1999	2000	1999
Operating activities				
Net income	118	91	244	201
Adjustments for non-cash items:				
Depreciation and amortization (net of removal costs)	79	81	156	152
Transitional cost adjustment	–	–	–	55
Other	(11)	16	5	25
	186	188	405	433
Changes in non-cash balances related to operations	(12)	151	(26)	189
Net cash generated from operations	174	339	379	622
Financing activities				
Debt for long-term financing:				
Issued	1,000	–	1,000	194
Retired	(954)	–	(954)	(362)
Dividends paid	(84)	–	(255)	–
Net cash used in financing activities	(38)	–	(209)	(168)
Investing activities				
Fixed assets	(179)	(110)	(312)	(204)
Other assets	(21)	(1)	(21)	(9)
Net cash used in investing activities	(200)	(111)	(333)	(213)
Net change in cash and cash equivalents	(64)	228	(163)	241
Cash and cash equivalents at beginning of period	369	52	468	39
Cash and cash equivalents at end of period	305	280	305	280

See accompanying notes to the consolidated financial statements

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements presented herein have been prepared in accordance with the accounting policies described in the consolidated financial statements for the years ended December 31, 1999 and December 31, 1998, and should be read in conjunction with those financial statements.

2. CAPITALIZATION

On March 31, 2000, the Corporation issued to the Province of Ontario (the Province) 12,920,000 5.5% cumulative preferred shares with a redemption value of \$25.00 per share, and 99,990 common shares bringing the total number of outstanding common shares to 100,000. The Corporation is authorized to issue an unlimited number of preferred and common shares.

In consideration of the Corporation's issuance to the Province of preferred shares and common shares, the Province assumed the Corporation's obligations, including accrued interest from April 1, 1999, under the \$3.76 billion promissory note effective as of March 31, 2000 and, in connection with the assumption of the Corporation's obligations by the Province, the Ontario Electricity Financial Corporation has released the Corporation effective as of March 31, 2000 from its obligations under the promissory note.

The preferred shares are entitled to an annual aggregate cumulative dividend of \$18 million which is payable on a quarterly basis. The preferred shares are redeemable at the option of the Province at a price of \$25.00 per share plus any accrued and unpaid dividends if the Province sells a number of the Corporation's common shares which it owns to the public such that the Province's holdings are reduced to less than 50% of the Corporation's common shares. Hydro One may elect to pay all or part of this redemption price by issuing additional common shares to the Province. If the Province does not exercise its redemption right, the Corporation would have the ability to adjust the dividend yield on the preferred shares to produce a yield that is .50% less than the then current dividend market yields for similarly rated preferred shares. The preferred shares do not carry voting rights, except in limited circumstances, and would rank in priority to the common shares upon liquidation.

The common dividends are declared at the sole discretion of the Hydro One Board of Directors, and recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice and shareholder expectations. In accordance with resolutions made by the Board of Directors, in respect of the nine months ended December 31, 1999, approximately \$13.3 million in preferred dividends and \$158 million in common dividends were paid to the Province, for a total of approximately \$171.3 million, on March 31, 2000.

On April 4, 2000, preferred dividends were declared in the amount of approximately \$4.4 million, which were paid on April 17, 2000. On May 9, 2000, common dividends were declared in the amount of \$79 million, which were paid on May 15, 2000. These dividends were paid in respect of the three months ended March 31, 2000.

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

3. CHANGE IN ACCOUNTING POLICY

Effective January 1, 2000, Hydro One adopted the Canadian Institute of Chartered Accountants new accounting recommendations with respect to *Employees' Future Benefits*. As a result of adopting this new accounting standard, Hydro One recorded \$211 million to both the deferred pension asset and liability, representing the immediate recognition of the transition amount.

4. LONG-TERM DEBT

On May 25, 2000, Hydro One offered and sold its inaugural bond issue for par value of \$1 billion, issued in three series of \$200 million 5-year bonds at a coupon rate of 6.94%, \$400 million 10-year bonds at a coupon rate of 7.15% and \$400 million 30-year bonds at a coupon rate of 7.35%. The issue of the bonds closed on June 1, 2000. Subsequently, \$954 million of debt owing to the Ontario Electricity Financial Corporation was repaid. The impact of refinancing maturing debt will be an increase in annual interest costs of about \$12 million.

5. SUBSEQUENT EVENT

On July 11, 2000, preferred dividends were declared in the amount of approximately \$4.4 million, and common dividends were declared in the amount of \$71 million. The preferred dividends were paid on July 17, 2000, and the common dividends were paid on August 15, 2000. These dividends were paid in respect of the three months ended June 30, 2000.

6. SEGMENTED INFORMATION

Hydro One has three reportable segments:

- i. the transmission business, which comprises the core business of providing transportation and connection services, as well as various services such as telecommunications and secondary land use, is responsible for transmitting electricity throughout the Ontario electricity grid;
- ii. the distribution (including retail) business, which comprises the core business of delivering and selling electricity to customers, as well as energy services; and
- iii. an "other" segment primarily consisting of the results of Ontario Hydro International Inc. for 1999.

The designation of segments has been based on the nature of the products and services provided.

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

Segment information on the above basis is as follows:

(Canadian dollars in millions)	Three months ended June 30		Six months ended June 30	
	2000	1999	2000	1999
Transmission				
Revenues	319	300	641	605
Operation, maintenance and administration	92	80	204	173
Depreciation and amortization	43	45	90	87
Segment profit before financing charges and payments in lieu of corporate income taxes	184	175	347	345
Distribution (including retail)				
Revenues	360	402	866	920
Operation, maintenance and administration	87	88	179	178
Purchased power	175	193	436	457
Depreciation and amortization	38	40	73	71
Segment profit before financing charges and payments in lieu of corporate income taxes	60	81	178	214
Other				
Revenues	–	28	–	55
Operation, maintenance and administration	–	12	–	23
Purchased power	–	14	–	27
Depreciation and amortization	–	1	–	3
Segment profit before financing charges and payments in lieu of corporate income taxes	–	1	–	2
Capital expenditures				
Transmission	81	47	163	113
Distribution (including retail)	48	53	79	86
Other	–	–	–	5
	129	100	242	204

HYDRO ONE INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

(Canadian dollars in millions)	June 30, 2000	December 31, 1999
Total assets		
Transmission	6,718	6,658
Distribution (including retail)	3,471	3,431
Other	—	1
	10,189	10,090

All consolidated revenues, costs and assets are earned, incurred or held in Canada, except for the operations of Ontario Hydro International Inc.

HYDRO ONE INC.
MANAGEMENT DISCUSSION AND ANALYSIS OF THE FINANCIAL RESULTS

Net income was \$118 million for the three months ended June 30, 2000 compared with \$91 million for the comparable period in 1999, representing an increase of \$27 million, or 30%.

Revenues declined by \$51 million, or 7%, to \$679 million compared with \$730 million for the second quarter of 1999. Revenue from our distribution (including retail) business declined by \$42 million. This reduction is attributable to lower revenue associated with the sale and delivery of electricity to our retail customers and lower revenue attributable to the transitional rate order approved by the Ontario Energy Board (OEB), partially offset primarily by an increase in services provided to the other successor corporations of Ontario Hydro. The winding-up of our subsidiary, Ontario Hydro International Inc. (OHI), including the sale of its 25% interest in Ontario Quinta A.V.V. (Ontario Quinta) on September 15, 1999 resulted in a reduction in revenue of \$28 million. The decline in revenues from these segments was partially offset by a \$19 million increase in transmission revenue. This increase is attributable to the higher allowed rate of return of 9.88% compared with 9.35% approved by the OEB and an increase in services provided to the other successor corporations of Ontario Hydro.

Operating costs declined by \$38 million, or 8%, to \$435 million compared with \$473 million for the second quarter of 1999. The reduction in purchased power costs of \$32 million mirrors the reduction in revenue attributable to the sale and delivery of electricity to our retail customers and the reduction due to the sale of the equity interest in Ontario Quinta. The reduction in depreciation and amortization of \$5 million is primarily due to a reduction in fixed asset removal costs. Within operation, maintenance and administration, incremental costs incurred to provide additional services to the other successor corporations of Ontario Hydro were primarily offset by a reduction in distribution (including retail) work program costs and from the winding-up of OHI, including the sale of its 25% interest in Ontario Quinta.

Financing charges declined by \$2 million, or 2%, to \$84 million compared with \$86 million for the second quarter of 1999. This decrease primarily reflects a higher amount of interest capitalized due to an increase in the average level of construction in progress.

The provision for payments in lieu of corporate income taxes declined by \$38 million, or 48%, to \$42 million compared with \$80 million for the second quarter of 1999. This reduction is primarily the result of an increase in deductions recognized in the current quarter for tax purposes but in different periods for accounting purposes. Such deductions primarily refer to payments under the staff reduction program, capital cost allowance claims and other post retirement benefit payments.

For the six months ended June 30, 2000, revenues were \$1,507 million compared to \$1,580 million for the same period in 1999. Net income was \$244 million compared with \$201 million in the corresponding period in 1999.