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**Our first quarter interim
financial report 2001**



Hydro One First Quarter Net Income Increases

TORONTO, Ontario (May 14, 2001) – Hydro One Inc. today announced its financial results for the first quarter of 2001. For the period ended, March 31, 2001, net income was up 6% to \$134 million compared to \$126 million last year.

“We are achieving our goal of reducing expenses while improving efficiencies in the business,” said Eleanor Clitheroe, President and Chief Executive Officer of Hydro One. “In addition, our program of integrating acquired municipal electric utilities into Hydro One’s existing network is proceeding well.”

The increase in net earnings was the result of lower operations, maintenance and administration expenses primarily due to lower sustaining and recoverable work program costs. Revenues totaled \$816 million versus \$828 million in 2000. Net cash flow provided from operations increased 34% to \$247 million compared with \$185 million in 2000. Cash flow increased as the business generated an additional \$62 million from operations.

Hydro One Inc., through its subsidiaries, is principally engaged in electricity transmission, distribution and energy services businesses. Through a wholly owned subsidiary, Hydro One Networks Inc., it owns and operates the largest transmission and distribution system in Ontario and one of the 10 largest in North America.

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HYDRO ONE INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Net income increased by \$8 million, or 6%, over first quarter results for 2000 to \$134 million. This increase was primarily due to lower operation, maintenance and administration (OM&A) costs, net of recoverable work.

Total revenues declined by \$12 million, or 1%, to \$816 million. Given the extension of the transitional rate orders for our transmission and distribution businesses, tariff related revenue was consistent with the comparative period. Transmission revenue of \$304 million declined by \$18 million, primarily due to a reduction in services provided to external parties. We were awarded work early in 2000 related to preparations for the opening of the electricity market, which was previously expected to occur during the fourth quarter of last year. Distribution (including retail) revenue increased by \$7 million to \$505 million, due to a reduction in line losses and slightly higher volume. Increased volume from acquired municipal electricity utilities was partially offset by lower demand from the original customer base. Other revenue of \$7 million was reasonably consistent with the comparative period.

Operating costs declined by \$29 million, or 5%, to \$518 million. A reduction of \$33 million in total OM&A was partially offset by marginal increases in purchased power and depreciation and amortization expense. OM&A for our transmission business was \$37 million lower than the first quarter of 2000. This reduction was a result of lower costs in sustaining and recoverable work programs. The reduction in sustaining work program costs was primarily related to preventive and corrective maintenance on transformer stations and telecommunications equipment. The reduction in recoverable work program costs reflects the reduction in services provided to external parties. OM&A attributable to our distribution and other businesses increased slightly over the comparative period.

Financing charges increased by \$4 million, or 5%, to \$86 million. This increase primarily reflects a reduction of \$6 million from interest income and an increase of \$3 million from higher average interest rates on debt, partially offset by a reduction of \$5 million from lower average debt levels. We held temporary investments in 2000 to manage liquidity until the commercial paper program was established in the third quarter of that year.

Provision for payments in lieu of corporate income taxes increased by \$5 million, or 7%, to \$78 million primarily as a result of the increase in the level of income. Lower provision for payments in lieu of corporate taxes due to a reduction in the statutory tax rate was offset by lower deductions, including cash payments made in 2000 for the staff reduction program.

CASH FLOWS AND BALANCE SHEET

Cash and cash equivalents increased during the first quarter of 2001 by \$46 million to a balance of \$22 million at March 31, 2001 compared to a decline of \$99 million in the comparative quarter. This net increase in cash flow of \$145 million was primarily associated with a reduction of \$81 million in cash used in financing activities. Dividends paid in the first quarter of 2000 pertained to the nine months ended December 31, 1999 consistent with the issuance of shares to the Province of Ontario on March 31, 2000. Subsequent to the issuance of shares, quarterly dividends have been declared and paid on a conventional basis. The reduction in dividends paid was partially offset by the repayment of maturing debt in the quarter. The remaining increase in cash flow was primarily due to the increase of \$62 million in net cash generated from operations. In addition to the increase in cash from operations, non-cash working capital declined relative to the comparative period primarily due to the timing of interest payments associated with our inaugural bond issue and lower accounts receivable consistent with the reduction in sales of services to external parties.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The increase in regulatory assets and long-term accounts payable and accrued charges reported on the Consolidated Balance Sheet does not substantially impact cash flow. We changed our accounting policy for estimated future expenditures required to remediate past environmental contamination. We now provide for the net present value of these estimated future expenditures rather than charging them to operations as incurred. The corresponding increase in regulatory assets reflects our expectation that we will continue to recover these expenditures in future rates (See Note 3 to the Consolidated Financial Statements).

LIQUIDITY AND CAPITAL RESOURCES

In addition to the costs and expenses incurred to conduct our ongoing operations, principal liquidity and capital resource requirements continue to consist of capital expenditures primarily to sustain, improve and expand our transmission and distribution assets, debt servicing, dividend payments and payments in lieu of corporate taxes.

Capital expenditures for the first quarter were \$102 million compared with \$113 million for the first quarter of 2000. Lower spending within transmission was substantially offset by increased distribution investments, primarily related to our municipal electricity utility acquisition program. Capital expenditures of \$4 million for other operations also increased over the prior year.

Capital expenditures for our transmission business amounted to \$39 million, a reduction of \$43 million over the comparative period. Investments of \$26 million in our transmission stations, lines, equipment and telecommunications refurbishments were \$31 million lower than in the first quarter of 2000. Spending to replace our aging analog protection and control microwave radio system with fibre-optic lines consisted of planning and engineering costs in support of phase 3 construction. During the first quarter of 2000, phase 2 construction involving 14 sites in Southern Ontario was well underway. Capital expenditures of \$7 million incurred to expand the transmission system were \$14 million lower than the comparative period. During the first quarter of 2000 work on a dedicated transmission service to the auto industry was substantially completed and construction of the first phase shifter at the interconnection with the State of Michigan was well underway. Capital expenditures to support operations, increase efficiency and reduce costs amounted to \$6 million, reasonably consistent with the first quarter of 2000.

Capital expenditures for our distribution (including retail) business increased by \$30 million to \$59 million for the first quarter of 2001. Of this amount, \$19 million relates to the acquisition of an additional 12 municipal electricity utilities. We also incurred a further \$2 million in support of pending acquisitions. Expenditures to support operations, enhance efficiency and reduce costs amounted to \$8 million, an increase of \$7 million over the comparative period. This increase reflects the continued preparation of our systems and processes for the opening of the competitive electricity market (Open Access). Customer-demand-driven and asset sustainment capital expenditures amounted to \$30 million, substantially consistent with the first quarter of 2000.

Sources of liquidity and capital resources continue to include cash generated from operations and our short-term credit facility. We also continue to be in the process of establishing our Canadian Medium Term Note program with applicable Canadian securities regulators. We expect this program to meet most of our 2001 and 2002 borrowing requirements, including the funding of our municipal electricity utility acquisitions.

RISK MANAGEMENT

As disclosed in our 2000 Annual Report, we are exposed to risks related to the following: market, credit, regulatory, environment, transfer of title to certain assets and to negotiations with our unions. We are continuing to implement an enterprise risk management policy and framework that aims to balance these risks while optimizing returns.

HYDRO ONE INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

With respect to risk management, on March 30, 2001 we entered into a forward interest rate swap agreement with a notional principal amount of \$85 million. We have entered into this transaction to hedge against the effect of future interest rate movements on our long-term borrowing requirements. Derivative financial instruments, such as interest rate swap agreements, result in exposure to credit risk, since there is a risk of counter-party default. To minimize this risk, our transaction involves a highly rated counter-party and the agreement incorporates a netting provision. Netting provisions enable the settlement of derivative financial assets and liabilities with the counter-party on a net basis in the event of counter-party default. The credit rating of the counter-party will be regularly monitored.

The OEB has heightened its focus on ensuring the readiness of the province's electricity distributors for Open Access. In so doing, it extended transmission and distribution licenses to March 31, 2003. As for all distributors, fulfillment of market ready preparations will become a condition of our distribution license. We believe that our distribution business is well positioned to meet its market ready obligations. The transitional distribution and transmission rate orders for 2000 have also been extended. These transitional rate orders provide for an annual rate of return on average common equity of 9.88%. Average common equity allocated to these businesses, for regulatory purposes, total approximately \$2.9 billion. In addition, the OEB has issued a procedural order related to the distribution rate application that we filed on January 19, 2001. This order states that the OEB is considering approving the distribution revenue requirement for the first-year of the rate period on an interim basis and that such approval would be granted in conjunction with a full proceeding, to be held in the fall of 2001. On March 30, 2001, the Province issued a regulation that increases the cost of wholesale power generated by Ontario Power Generation Inc. by 0.7 cents per kWh, effective, June 1, 2001. Hydro One, in its capacity as billing agent, will pass this non-distribution-related increase through to customers.

The renewal collective agreement with the Power Worker's Unions was ratified by 73.4% of the voting members. The agreement is for a one-year period, commencing April 1, 2001. We believe that the settlement is well balanced and reasonable and will enable us to continue to pursue productivity initiatives.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2001	2000
Revenues		
Transmission	304	322
Distribution (including retail)	505	498
Other	7	8
	816	828
Costs		
Operation, maintenance and administration	171	204
Purchased power	263	261
Depreciation and amortization	84	82
	518	547
Income before financing charges and provision for payments in lieu of corporate income taxes	298	281
Financing charges	86	82
Income before provision for payments in lieu of corporate income taxes	212	199
Provision for payments in lieu of corporate income taxes	78	73
Net income	134	126

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (unaudited)

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2001	2000
Retained earnings, beginning of period	241	265
Net income	134	126
Dividends	(27)	(171)
Retained earnings, end of period	348	220

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS

<i>(Canadian dollars in millions)</i>	March 31, 2001	December 31, 2000
	(unaudited)	
Assets		
Current assets		
Cash and cash equivalents	22	-
Accounts receivable (net of allowance for doubtful accounts)	512	511
Materials and supplies	64	65
	598	576
Fixed assets		
Fixed assets in service	12,447	12,375
Less: accumulated depreciation	4,185	4,108
	8,262	8,267
Construction in progress	280	252
	8,542	8,519
Other long-term assets		
Regulatory assets	535	352
Deferred pension asset	452	452
Long-term accounts receivable and other assets	76	78
Goodwill (net of amortization)	11	6
Deferred debt costs	13	14
	1,087	902
Total assets	10,227	9,997
Liabilities		
Current liabilities		
Bank indebtedness	-	24
Accounts payable and accrued charges	341	357
Accrued interest	121	64
Short-term notes payable	100	130
Long-term debt payable within one year	440	474
	1,002	1,049
Long-term debt	3,972	3,972
Other long-term liabilities		
Employee future benefits other than pension	520	509
Regulatory liability	452	452
Long-term accounts payable and accrued charges	174	15
	1,146	976
Total liabilities	6,120	5,997
Shareholder's equity (Note 2)		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	323
Common shares (authorized: unlimited; issued: 100,000)	3,436	3,436
Retained earnings	348	241
Total shareholder's equity	4,107	4,000
Total liabilities and shareholder's equity	10,227	9,997

See accompanying notes to Consolidated Financial Statements.

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

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2001	2000
Operating activities		
Net income	134	126
Adjustments for non-cash items:		
Depreciation and amortization (net of removal costs)	84	77
	218	203
Changes in non-cash balances related to operations	29	(18)
Net cash generated from operations	247	185
Financing activities		
Debt for long-term financing:		
Issued	-	-
Retired	(34)	-
Debt for short-term financing	(30)	-
Deferred debt costs	1	-
Dividends paid	(27)	(171)
Net cash used in financing activities	(90)	(171)
Investing activities		
Fixed assets	(83)	(113)
Acquisitions of municipal electricity utilities	(26)	-
Other assets	(2)	-
Net cash used in investing activities	(111)	(113)
Net change in cash and cash equivalents	46	(99)
Cash and cash equivalents, beginning of period	(24)	468
Cash and cash equivalents, end of period	22	369

See accompanying notes to 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, 2000 and December 31, 1999, except as described in Note 3, and should be read in conjunction with those financial statements.

2. CAPITALIZATION

On March 31, 2000, the Company 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. As consideration, the Province assumed Hydro One's obligations, including accrued interest from April 1, 1999 under a promissory note and, in connection with the assumption of the Company's obligations by the Province, the Ontario Electricity Financial Corporation released Hydro One, 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 unpaid dividends if the Province sells the Company's common shares to the public such that the Province's holdings are reduced to less than 50% of the Company'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 Company 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 yield, 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, \$13 million in preferred dividends and \$158 million in common dividends were paid to the Province on March 31, 2000.

On February 13, 2001, preferred dividends in respect of the three months ended March 31, 2001 were declared in the amount of approximately \$4.4 million and paid on April 16, 2001. Also on February 13, 2001, common dividends in respect of the three months ended December 31, 2000, were declared in the amount of \$23 million, and were paid on February 15, 2001. Common dividends in respect of the three months ended March 31, 2001 will be declared on May 15, 2001.

3. CHANGE IN ACCOUNTING POLICY

Hydro One changed its accounting policy for estimated future expenditures required to remediate past environmental contamination. The Company now provides for the net present value of these estimated future expenditures and, effective January 1, 2001, recorded a provision in the amount of \$190 million. Previously, such expenditures were charged to operations as incurred. Expenditures of this nature have been recoverable through rates in the past and, because Hydro One expects this rate treatment to continue, a regulatory asset was recognized in an amount equivalent to the environmental provision. This regulatory asset is expected to be amortized over the period to 2020.

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

4. ACQUISITIONS OF MUNICIPAL ELECTRICITY UTILITIES

Hydro One has entered into numerous agreements to acquire the outstanding shares or assets of municipal electricity utilities. The Company accounts for such acquisitions using the purchase method with the acquired companies' results of operations being included in the Consolidated Statement of Operations from the date of acquisition. The purchase of each municipal electricity utility must be approved by the Ontario Energy Board prior to closing.

During the first quarter of 2001, Hydro One acquired 12 small municipal electricity utilities for cash consideration of approximately \$25 million. Net identifiable assets acquired amounted to approximately \$20 million, representing assets of \$24 million and liabilities of \$4 million. Based on the allocation of the purchase price, the transactions resulted in goodwill of \$5 million. The Company also recorded purchase price adjustments in the amount of \$1 million related to the acquisition of municipal electricity utilities in 2000.

In addition, Hydro One has entered into agreements for the purchase of 59 other municipal electricity utilities, which are expected to close in 2001. The aggregate cost of these acquisitions will be approximately \$474 million. These acquisitions include the purchase of Brampton Hydro Corporation for cash consideration of approximately \$260 million. Deposits in the amount of \$55 million have been made in respect of these acquisitions.

5. FINANCIAL INSTRUMENTS

On March 30, 2001 Hydro One entered into a forward interest rate swap agreement with a notional principal amount of \$85 million. Based on quarter-end market rates, the Company would have to pay approximately \$0.2 million to terminate the contract. This transaction has been entered into for the purpose of hedging against the effect of future interest rate movements on long-term borrowing requirements. The Company follows hedge accounting for interest rate swap agreements whereby the net interest rate differentials to be paid or received are recorded as adjustments to financing charges.

Derivative financial instruments, such as interest rate swap agreements, result in exposure to credit risk since there is a risk of counter-party default. To minimize this risk, the Company enters into such transactions with highly rated counter-parties and incorporates netting provisions into the agreements. Netting provisions enable the settlement of derivative financial assets and liabilities with the counter-party on a net basis in the event of counter-party default. The credit rating of counter-parties will be regularly monitored.

6. SEGMENTED REPORTING

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; and
- III. An "other" segment primarily consisting of energy services, power procurement, telecom and head office.

The designation of segments has been based on a combination of regulatory status and the nature of the products and services provided. Segment information on the above basis is as follows:

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

<i>Three months ended March 31 (Canadian dollars in millions)</i>	2001	2000
Transmission		
Revenues	304	322
Operation, maintenance and administration	75	112
Depreciation and amortization	51	47
Income before financing charges and provision for payments in lieu of corporate income taxes	178	163
Distribution (including retail)		
Revenues	505	498
Operation, maintenance and administration	84	82
Purchased power	262	261
Depreciation and amortization	32	33
Income before financing charges and provision for payments in lieu of corporate income taxes	127	122
Other		
Revenues	7	8
Operation, maintenance and administration	12	10
Purchased power	1	-
Depreciation and amortization	1	2
Loss before financing charges and provision for payments in lieu of corporate income taxes	(7)	(4)
Capital expenditures		
Transmission	39	82
Distribution (including retail)	59	29
Other	4	2
	102	113

<i>(Canadian dollars in millions)</i>	March 31, 2001	December 31, 2000
Total assets		
Transmission	6,539	6,492
Distribution (including retail)	3,598	3,434
Other	90	71
	10,227	9,997

All consolidated revenues, costs and assets, as the case may be, are earned, incurred or held in Canada.

7. COMPARATIVE FIGURES

The comparative Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the March 31, 2001 Consolidated Financial Statements.