

Hydro One announces second quarter net income

Toronto, August 11, 2004 - Hydro One Inc. today released its second quarter results with net income of \$190 million and revenues of \$2,072 million for the six months ended June 30, 2004.

Net income decreased by \$20 million, or 24%, in the second quarter and by \$34 million, or 15%, in the first six months compared to 2003 results. These reductions reflect the impact of higher operations, maintenance and administration costs associated with our work programs and our pension plan contributions. Through our ongoing work programs, we incurred increased expenditures necessary to upgrade, maintain and reinforce the high-voltage transmission network and low-voltage distribution system. Similarly, we incurred higher depreciation charges related to increased transmission and distribution investments. Capital expenditures of \$345 million for the first six months of 2004 increased by \$111 million, or 47%, compared to the same period in 2003, primarily due to projects to expand and reinforce the electricity system. These projects address the impact of growing loads and the closure of the Lakeview Generating Station on the electricity network, as well as increase the performance and capability of the distribution system.

For the six months to June 30, 2004, total revenue decreased by \$28 million, or 1%, compared to last year, primarily due to lower transmission revenues reflecting milder winter temperatures and cooler spring temperatures. Net cash from operations was \$484 million for the first six months of 2004. During this period, the Company has paid \$142 million in dividends to the Government of Ontario and invested \$345 million in capital expenditures, primarily in the transmission and distribution systems.

“Overall, the financial results are in line with our expectations. The higher levels of expenditures are consistent with our focus on core operations and investments in Ontario wires. Expansion and reinforcement of Ontario’s electricity system remains a key element of our strategy” said Tom Parkinson, President and Chief Executive Officer of Hydro One.

RECENT DEVELOPMENTS

- On June 1, 2004, we filed an application with the Ontario Energy Board (OEB) requesting approval for the establishment of a regulatory deferral account effective January 1, 2004 to record cash pension costs and interest thereon in relation to the distribution business and confirmation of the prudence of our pension costs. The application proposed an interim rate mechanism to allow recovery of these pension costs commencing March 1, 2005. On July 14, 2004, the OEB issued an order approving the establishment of a regulatory deferral account to record cash payments related to distribution pension costs and interest thereon. The OEB noted in its decision that it would not rule on the prudence of these costs at this time, but that prudently incurred costs of this type are normally recoverable as part of a general rate adjustment application. Given the OEB’s order, we have determined that it is appropriate, in the third quarter, to reflect approximately \$16 million of distribution pension costs previously expensed this year, as well as future distribution pension costs covered by the OEB’s order, as a regulatory asset.

- On June 15, 2004, the Minister of Energy introduced Bill 100, *An Act to amend the Electricity Act, 1998 and the Ontario Energy Board Act, 1998 and to make consequential amendments to other Acts*. If passed, the proposed legislation would reorganize Ontario's electricity sector to ensure efficient and effective management over the long-term; ensure sufficient electricity supply; encourage electricity conservation and renewable energy; and facilitate electricity demand management. We anticipate transmission and distribution to be addressed by the Minister of Energy later this year.
- On July 14, 2004, the Minister of Energy issued a directive to the OEB under the *Ontario Energy Board Act, 1998*, requiring the OEB to develop a plan to implement the installation of smart electricity meters to manage demand, make more efficient use of current supply and reduce reliance on external sources. The OEB is to provide the implementation plan to the Minister of Energy by February 15, 2005. The Government is targeting the installation of 800,000 smart meters by December 31, 2007, and the installation of smart meters for all Ontario customers by December 31, 2010.
- The Ontario Grid Control Centre, our new operating centre in Barrie, was recently fully staffed and now controls our entire transmission and distribution system. The official opening is scheduled for August 12, 2004.

CONSOLIDATED FINANCIAL HIGHLIGHTS AND STATISTICS

<i>(Canadian dollars in millions) (except as otherwise noted)</i>	Three months ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Revenues	966	953	2,072	2,100
Purchased power	455	424	995	1,000
Operating costs	337	311	634	592
Net income	65	85	190	224
Net cash from operations	210	250	484	516
Transmission – units transmitted (TWh) ¹	35.7	35.6	76.8	76.6
Distribution – units distributed (TWh) ¹	6.3	6.1	14.6	14.3
Average Ontario 60-minute Peak Demand (MW) ¹	21,134	21,501	22,097	22,541

¹ System related statistics are preliminary

Hydro One Inc. is a holding company that operates through its subsidiaries in electricity transmission and distribution and telecom businesses. One of its subsidiaries, Hydro One Networks Inc., operates one of the largest transmission and distribution systems in North America. Hydro One Inc. is wholly owned by the Ontario government.

- 30 -

For further information, please contact:
 Peter Gregg,
 Vice President, Corporate Communications
 416-345-6072

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

As used in this section, references to increases and decreases, whether in terms of amounts or percentages are made by comparison of the three and six months ended June 30, 2004 to the three and six months ended June 30, 2003.

Revenues

<i>(Canadian dollars in millions)</i>	Three months ended June 30				Six months ended June 30			
	2004	2003	\$ Change	% Change	2004	2003	\$ Change	% Change
Transmission	307	323	(16)	(5)	629	658	(29)	(4)
Distribution	655	619	36	6	1,435	1,427	8	1
Other	4	11	(7)	(64)	8	15	(7)	(47)
	966	953	13	1	2,072	2,100	(28)	(1)
Transmission - units transmitted (TWh) ¹	35.7	35.6	0.1	-	76.8	76.6	0.2	-
Distribution - units distributed (TWh) ¹	6.3	6.1	0.2	3	14.6	14.3	0.3	2
Average Ontario 60-minute peak demand (MW) ¹	21,134	21,501	(367)	(2)	22,097	22,541	(444)	(2)

¹System-related statistics are preliminary

The demand for electricity generally follows normal weather-related variations, and therefore our energy-related revenues, all other things being equal, will tend to be higher in the first and third quarters than in the second and fourth quarters.

Transmission revenues consist predominantly of our transmission tariff, which is based on the peak demand for electricity across our high-voltage network. The level of peak demand is primarily influenced by weather conditions. As a result of a cooler spring and milder winter this year, the average peak demand was approximately 367 MW lower in the second quarter and 444 MW lower in the first six months compared to the same periods in 2003 and accordingly, our transmission tariff revenues were lower. Peak demand was lower this year for all months except January and May. Ancillary revenues, including those associated with contract work for other industry participants, were also lower this year, both in the quarter and year-to-date.

Distribution revenues include our distribution tariff, which is based on Ontario Energy Board (OEB) approved rates, recovery for the cost of purchased power used by our customers and ancillary distribution services. Accordingly, distribution revenues are primarily influenced by our distribution rates, the amount of electricity we distribute and the cost of purchased power.

Higher distribution revenues in the second quarter of 2004 compared to last year primarily reflect higher purchased power costs of \$31 million due to the implementation of the two-tiered fixed interim pricing structure on April 1, 2004 partially offset by a lower average Hourly Ontario Energy Price (HOEP). The remaining increase primarily reflects marginally higher distribution tariff revenues.

During the first six months, distribution revenues increased by \$8 million compared to the same period in the prior year. This increase primarily reflects marginally higher distribution tariff revenues, partially offset by lower purchased power costs that were primarily attributable to a lower average HOEP.

Other revenue decreased both in the second quarter and on a year-to-date basis compared to 2003 results, primarily due to lower sales of dark fibre partially offset by growth in other areas of our telecommunications business.

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

Purchased Power

Purchased power costs incurred by our distribution business represent the cost of electricity delivered to customers within our distribution service area and consist of the wholesale commodity cost of energy, Independent Electricity Market Operator's (IMO) wholesale market service charges and transmission charges levied by the IMO. For certain low volume and designated customers, the wholesale commodity price of energy had been fixed. On April 1, 2004, the fixed price of 4.3 cents per kWh was replaced by an interim pricing structure of 4.7 cents per kWh for the first 750 kWhs consumed per month and 5.5 cents per kWh for any additional consumption. Customers who are not eligible for the interim pricing structure pay the wholesale commodity price of energy, which is based on the HOEP established by the IMO spot market.

Purchased power costs increased by \$31 million, or 7%, to \$455 million in the second quarter as compared to 2003 primarily as a result of the implementation of the interim pricing structure on April 1, 2004, partially offset by a lower average HOEP. The average monthly weighted-average HOEP was 4.91 cents per kWh for the second quarter, down from 5.07 cents per kWh for the same period last year. During the first six months, purchased power costs decreased by \$5 million, to \$995 million, as the impact of the interim pricing structure implemented in the second quarter was more than offset by a lower average HOEP for the entire period. The average monthly weighted-average HOEP was 5.36 cents per kWh in the first six months of this year, down from last year's year-to-date average of 6.46 cents per kWh.

Operation, Maintenance and Administration

Our operation, maintenance and administration costs are comprised primarily of labour, material, equipment and purchased services in support of the operation and maintenance of the transmission and distribution systems. These costs also include property taxes and payments in lieu thereof on our transmission and distribution lines, stations and buildings. Commencing in 2004, operation, maintenance and administration and capital expenditures include the recognition of pension contribution costs. As a result of an actuarial valuation that will be filed with the Financial Services Commission of Ontario, we expect to make contributions to our pension plan of approximately \$80 million per year, for the next three years (see Recent Developments).

Operation, maintenance and administration costs for each of our three business segments were as follows:

<i>(Canadian dollars in millions)</i>	Three months ended June 30				Six months ended June 30			
	2004	2003	\$ Change	% Change	2004	2003	\$ Change	% Change
Transmission	103	95	8	8	188	189	(1)	(1)
Distribution	113	99	14	14	210	181	29	16
Other	6	8	(2)	(25)	10	14	(4)	(29)
	222	202	20	10	408	384	24	6

Transmission operation, maintenance and administration expenditures necessary to sustain our high-voltage system were higher by \$8 million in the second quarter and substantially unchanged on a year-to-date basis compared to the respective periods last year. Expenditure levels reflect the funding requirements for our pension plan and higher planned and corrective maintenance expenditures to ensure the continued reliability of our transmission stations. In addition, second quarter property taxes increased due to the impact of a reassessment. These increases were offset partially in the second quarter and substantially year-to-date by the impact of the reassignment of resources to support the larger transmission capital work program.

Distribution operation, maintenance and administration costs necessary to maintain our distribution system increased by \$14 million in the second quarter and \$29 million in the first six months compared to the same periods in 2003. These increases reflect the funding requirements of our pension plan as well as an enhancement and earlier start to our forestry program this year. The clearing of trees and brush on our rights of way is being enhanced to allow us to maintain reliability and reduce vegetation-caused power outages on our system. We also experienced higher customer care costs necessary to implement the Government's electricity policy. These increases were partially offset by the reassignment of resources to support the larger distribution capital work program.

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

Other operation, maintenance and administration costs were \$2 million lower in the quarter and \$4 million lower on a year-to-date basis, than in the comparative periods. These reductions are consistent with the reduced sales of dark fibre and lower market prices paid for telecommunications services and fibre within our telecommunications business.

Depreciation and Amortization

Depreciation and amortization expense increased by \$6 million, or 6%, to \$115 million in the second quarter and by \$18 million, or 9%, to \$226 million in the first six months from the equivalent periods last year. These increases primarily result from an increase in fixed assets in service, consistent with the investments made in our electricity delivery network.

Financing Charges

Financing charges decreased by \$5 million, or 6%, to \$83 million in the second quarter and by \$6 million, or 3%, to \$168 million in the first six months compared to the respective periods last year. These reductions reflect the refinancing of our debt at lower average interest rates compared to the effective rates on the maturing debt, partially offset by the impact of a higher average level of debt outstanding in 2004 than in the comparative periods.

Provision for Payments in Lieu of Corporate Income Taxes

The provision for payments in lieu of corporate income taxes decreased by \$19 million, or 42%, to \$26 million in the second quarter and by \$25 million, or 23%, to \$85 million in the first six months compared to the same periods in 2003. These reductions reflect the lower levels of income before taxes and the impact of a reduction in the statutory tax rate from 36.62% to 36.12%.

Net Income

Net income of \$65 million for the second quarter and \$190 million for the first half of the year was \$20 million and \$34 million lower, respectively, compared to the 2003 results. These reductions reflect the impact of higher operations, maintenance and administration costs associated with our work programs and our pension plan contributions. Through our ongoing work programs, we incurred increased expenditures necessary to upgrade, maintain and reinforce the high-voltage transmission network and low-voltage distribution system. Similarly, we incurred higher depreciation charges related to increased transmission and distribution investments. Electricity revenues did not have a significant impact on net income as the reduction in transmission revenues was substantially offset by higher net revenue from the distribution of electricity.

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth unaudited quarterly information for each of the eight quarters ended September 30, 2002 through June 30, 2004. This information has been derived from our unaudited interim Consolidated Financial Statements which, in the opinion of our management, have been prepared on a basis consistent with the audited annual Consolidated Financial Statements and includes all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of our financial position and results of operations for those periods. These operating results are not necessarily indicative of results for any future period and should not be relied upon to predict our future performance.

<i>(Canadian dollars in millions)</i>	2004			2003			2002	
	Jun. 30	Mar. 31	Dec. 31	Sep. 30	Jun. 30	Mar. 31	Dec. 31	Sep. 30
Quarter ended								
Total revenue	966	1,106	1,009	949	953	1,147	999	1,097
Net income	65	125	79	93	85	139	27	112
Net income to common shareholder	61	120	75	88	81	134	23	107

The demand for electricity generally follows normal weather-related variations, and therefore our energy-related revenues and net income, all other things being equal, would tend to be higher in the first and third quarters than in the second and fourth quarters.

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

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity and capital resources are funds generated from operations, debt capital market borrowings and bank financing. These resources will be used to satisfy our capital resource requirements, which continue to include capital expenditures, servicing and repayment of our debt, payments related to our outsourcing arrangements, investing activities, and dividends.

Summary of Sources and Uses of Cash

<i>(Canadian dollars in millions)</i>	Three months ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Operating activities	210	250	484	516
Financing activities				
Long-term debt issued	120	750	370	1,250
Long-term debt retired	(237)	(651)	(472)	(651)
Short-term notes payable	142	77	117	(294)
Dividends paid	(62)	(60)	(142)	(125)
Investing activities				
Capital expenditures	(198)	(140)	(345)	(234)
Other financing and investing activities	15	(16)	15	(10)
Net change in cash and cash equivalents	(10)	210	27	452

Operating Activities

Net cash generated from operations decreased by \$40 million in the second quarter and by \$32 million in the first six months compared to the 2003 results. These decreases reflect lower net income levels and a smaller reduction in working capital than last year. The impact of fluctuations in accounts receivable balances due to varying market prices and the introduction of the interim pricing structure has been partially offset by increases in accounts payable, which now includes liabilities related to the funding requirements of our pension plan. We expect to begin making the required contributions to our pension plan later this year. In addition, for the first six months, increased adjustments of non-cash items such as depreciation expense and amortization of the debt discount have increased cash resources from operating activities.

Financing Activities

Short-term liquidity is provided through funds from operations and our commercial paper program, under which we are authorized to issue up to \$1 billion in short-term notes with a term to maturity of less than 365 days. This program is supported by committed revolving credit facilities with a syndicate of banks of \$750 million and \$250 million, both of which mature in August 2005. We plan to cancel the \$250 million facility. At June 30, 2004, we had \$142 million of short-term notes outstanding. The remaining available short-term liquidity of approximately \$608 million under this program and anticipated levels of funding from operations should be sufficient to fund our normal operating requirements. Long-term financing is provided by our access to the debt markets, including our medium term note program. After considering our most recent debt issue, we have approximately \$1.13 billion principal amount issuable under this program, available until July 2005. Our notes and debentures mature between 2005 and 2043. We currently plan to refinance maturing debt principally through our medium term note program.

Rating Agency	Rating	
	Short-term Debt	Long-term Debt
Standard & Poor's Rating Services Inc.	A-2	A
Dominion Bond Rating Service Inc.	R-1 (low)	A
Moody's Investor Services Inc.	Prime-1	A2

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

During the second quarter of 2004, we issued \$120 million in long-term debt under our medium term note program and we repaid \$237 million in maturing long-term debt. We also increased our short-term notes by \$142 million. In comparison, during the second quarter of 2003 we issued \$750 million in debt under our medium term note program, repaid \$651 million in maturing long-term debt and increased our short-term notes by \$77 million. On a year-to-date basis, we have issued \$370 million and have retired \$472 million in long-term debt compared to issuances of \$1,250 million and retirements of \$651 million in 2003. Year-to-date net increases in short-term notes totaled \$117 million compared to net reductions of \$294 million last year.

In the second quarter of 2004, we paid dividends to the Government of Ontario in the amount of \$62 million, consisting of \$57 million in common dividends and \$5 million in preferred dividends. In the comparative period during 2003, we paid common dividends of \$55 million and preferred dividends of \$5 million. Year-to-date, we have paid common and preferred dividends totaling \$142 million, compared to \$125 million in 2003.

Investing Activities

Cash used for investing activities primarily represents capital expenditures for each of our three business segments as follows:

<i>(Canadian dollars in millions)</i>	Three months ended June 30				Six months ended June 30			
	2004	2003	Change	%	2004	2003	Change	%
Transmission	117	64	53	83	198	112	86	77
Distribution	79	72	7	10	143	114	29	25
Other	2	4	(2)	(50)	4	8	(4)	(50)
	198	140	58	41	345	234	111	47

Transmission capital expenditures increased by \$53 million in the second quarter and by \$86 million on a year-to-date basis compared to the same periods last year. Capital expenditures to expand and reinforce our transmission system accounted for \$51 million of the increase in the quarter and for \$70 million in the first six months. These expansion and reinforcement projects will primarily address growing loads and the closure of Lakeview Generating Station, and include the new Parkway transformer station. The remainder of the increases reflect ongoing capital expenditures to ensure the reliability of our existing transmission stations, lines and equipment and to support our transmission operations. Construction of our integrated operating facility continued throughout the second quarter of 2004. This facility is expected to achieve cost efficiencies, improve customer response, and provide advanced monitoring and analysis capabilities. The funding requirements associated with our pension plan also contributed to the overall increases in our capital expenditures.

Distribution capital expenditures increased by \$7 million this quarter and by \$29 million on a year-to-date basis compared to the same periods in 2003. Expenditures to enhance our distribution system to accommodate increased loads, improve performance and mitigate risks increased by \$15 million in the quarter and \$27 million for the first six months compared to 2003. These increased expenditures reflect the effects of the OEB's Distribution System Code, which results in our company funding a greater proportion of customer-shared new connection and system upgrade costs than last year. The remainder of the change is due to increased expenditures to replace existing distribution station components, line assets and other equipment necessary to maintain reliability which, in the quarter, were more than offset by the impact of having fewer unplanned replacements due to reduced storm activity. The funding requirements associated with our pension plan also contributed to the overall increases in our capital expenditures.

Other capital expenditures decreased by \$2 million in the second quarter and by \$4 million in the first six months. These reductions reflect the completion of our fibre-optic network in 2003. The 2004 capital program reflects ongoing equipment upgrades commensurate with demand.

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

Summary of Contractual Obligations and Other Commercial Commitments

The following table presents a summary of our debt and other major contractual obligations as well as other major commercial commitments.

June 30, 2004

(Canadian dollars in millions)

	Total	2004¹	2005/2006	2007/2008	After 2008
Contractual Obligations (due by year):					
Short-term notes payable	142	142	-	-	-
Long-term debt	5,062	-	1,237	855	2,970
Operating lease commitments	22	5	9	6	2
Inergi LP outsourcing agreement	767	56	212	204	295
Total Contractual Obligations	5,993	203	1,458	1,065	3,267
Other Commercial Commitments (by year of expiry)					
Bank line ²	1,000	750	250	-	-
Letters of credit ³	86	72	14	-	-
Guarantees ³	275	275	-	-	-
Pension ⁴	243	81	162	-	-
Total Other Commercial Commitments	1,604	1,178	426	-	-

¹ The amounts disclosed represent the balance due over the period July 1, 2004 to December 31, 2004.

² As a backstop to our commercial paper program, we have a revolving standby credit facility with a syndicate of banks of \$750 million for a 364-day term maturing on August 13, 2004 and \$250 million for a five-year term maturing on August 18, 2005. On July 12, 2004, the \$750 million facility was extended to August 12, 2005, with a two year extension option to the 364 day facility. We plan to cancel the \$250 million five-year facility in August of this year.

³ We currently have bank letters of credit of \$69 million outstanding relating to retirement compensation arrangements. We have also provided prudential support to the IMO as required by the Market Rules, using a combination of bank letters of credit of \$12 million and parental guarantees of \$275 million. The amount of prudential support that we provide in the form of bank letters of credit to the IMO is dependent on our long-term credit ratings from major Canadian and U.S. rating agencies. The amount of bank letters of credit provided would need to increase if our credit ratings deteriorated. The remaining letters of credit pertain to operating letters of credit and to surety bonds.

⁴ Contributions after 2006 will be based on an actuarial valuation as at December 31, 2006 and will depend on future investment returns, changes in benefits or actuarial assumptions. Should financial market conditions improve significantly before December 31, 2006, we have the option to file an earlier actuarial valuation.

The amounts in the above table under short-term notes payable and long-term debt are not charged to our results of operations, but are reflected on our balance sheet and statement of cash flows. Interest associated with this debt is recorded under financing charges on our statement of operations or in our capital programs, but these financing charges are not reflected in the above table. Payments in respect of operating leases and our outsourcing agreement with Inergi LP are recorded under operation, maintenance and administration costs on our statement of operations or in our capital programs.

HYDRO ONE INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

RECENT DEVELOPMENTS

Prudency Review of Regulatory Account Balances

The OEB has approved the partial recovery of approximately \$160 million of regulatory assets through interim rate adjustments implemented on April 1, 2004. On May 31, 2004, we submitted evidence for a formal hearing on the prudency of the 2002 and 2003 regulatory account balances. We are seeking OEB approval to reflect adjustments to rates over the period March 1, 2005 to February 28, 2008. The prudency review is expected to commence on September 13, 2004.

Prudency Review and Rate Application for Pension Costs

On June 1, 2004, we filed an application with the OEB requesting approval for the establishment of a regulatory deferral account effective January 1, 2004 to record cash pension costs and interest thereon in relation to the distribution business and confirmation of the prudence of our pension costs. Our application proposed an interim rate mechanism to allow recovery of these pension costs commencing March 1, 2005.

On July 14, 2004, the OEB issued an order approving the establishment of a regulatory deferral account to record cash payments related to distribution pension costs and interest thereon. The OEB noted in its decision that it would not rule on the prudence of these costs at this time, but that prudently incurred costs of this type are normally recoverable as part of a general rate adjustment application. Given the OEB's order, we have determined that it is appropriate, in the third quarter, to reflect approximately \$16 million of distribution pension costs previously expensed this year, as well as future distribution pension costs covered by the OEB's order, as a regulatory asset.

On August 11, 2004, our Board of Directors approved a new actuarial valuation report to be submitted to the Financial Services Commission of Ontario in September. The report sets the required funding for each of 2004, 2005 and 2006 at about \$80 million per year. The reduction from the previous estimate of \$100 million primarily reflects the better than planned investment performance of the pension fund during 2003.

Transmission System Code Review

On June 8, 2004, the OEB issued its decision on the policy review phase of the Transmission System Code (TSC) review. The decision covers six main areas including available capacity; transmission system bypass; cost responsibility; contestability; economic evaluation; and contractual issues. We are currently reviewing the implications of the decision but anticipate that it could lower transmission tariff revenues associated with increased opportunity for customers to qualify for net load billing and the ability to bypass transformation and connection facilities when assets become fully depreciated. However, the decision also upholds the financial viability of the transmitter, as well as all operational, safety and reliability requirements of the transmission system, as a high priority for the OEB. In the next phase of the proceeding, the OEB will produce a draft TSC that incorporates the policy decisions of this first phase.

Bill 100, Electricity Restructuring Act

On June 15, 2004, the Minister of Energy introduced Bill 100, *An Act to amend the Electricity Act, 1998 and the Ontario Energy Board Act, 1998 and to make consequential amendments to other Acts*. The following measures are proposed:

- A new Ontario Power Authority (OPA), that would ensure an adequate, long-term supply of electricity, a mandate that no existing institution in the sector carries;
- A new Conservation Bureau led by the Province's first Chief Energy Conservation Officer;
- Provisions that the Ministry of Energy set targets for conservation, renewable energy, and the overall supply mix of electricity in the province;
- A redefinition of the role played by the IMO, as defined in its new name - the Independent Electricity System Operator. Some of the current responsibilities of the IMO would be moved to the OEB and the proposed OPA;
- Incentives for more private sector investment in new generation to help meet growing demand; and
- Regulated prices in parts of the electricity sector that would be adjusted and approved periodically by the OEB to ensure price stability for consumers.

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

If passed, the proposed legislation would reorganize Ontario's electricity sector to ensure efficient and effective management over the long-term; ensure sufficient electricity supply; encourage electricity conservation and renewable energy; and facilitate electricity demand management. We anticipate transmission and distribution to be addressed by the Minister of Energy later this year.

The proposed legislation, as well as a number of technical regulations identified in Bill 100, will be subject to extensive consultation and input over the summer months. We are currently assessing the impact of the proposed legislation on our company and will participate in the consultation process.

Electricity Meters

On July 14, 2004, the Minister of Energy issued a directive to the OEB under the *Ontario Energy Board Act, 1998*, as approved by Order in Council on June 23, 2004. The directive requires the OEB to develop and implement a plan to achieve the Government's objectives for the implementation of smart electricity meters to manage demand, make more efficient use of current supply and reduce reliance on external sources. The OEB is to provide the implementation plan to the Minister of Energy by February 15, 2005.

The Government is targeting the installation of 800,000 smart meters by December 31, 2007, and installation of smart meters for all Ontario customers by December 31, 2010. While the details of the program are not currently available, our preliminary estimate of the impact of this directive is capital investments in the range of \$400 million to \$600 million, and annual operating costs reaching about \$20 million by 2009. We anticipate that these costs will be recoverable through future rates.

SELECTED FINANCIAL HIGHLIGHTS AND RATIOS

<i>(Canadian dollars in millions) (except as otherwise noted)</i>	Three months ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Net income	65	85	190	224
EBITDA ¹	289	327	669	716
Net cash from operations	210	250	484	516
Capital expenditures	198	140	345	234
Earnings per common share <i>(Canadian dollars)</i>	602	806	1,810	2,149
Earnings coverage ratio ²			2.29	2.38
Net asset coverage on long-term debt ³			1.88	1.86
Total debt to capitalization ⁴			54%	54%

¹EBITDA has been presented for the three and six months ended June 30, 2004 and June 30, 2003 and has been calculated as the sum of income before financing charges, provision for payments in lieu of corporate income taxes and depreciation and amortization. We provide this non-GAAP measure because we believe that it is a standard and useful measure of our financial performance.

²The earnings coverage ratio has been presented for the twelve months ended June 30, 2004 and June 30, 2003, respectively and has been calculated as the sum of net income, provision for payments in lieu of corporate income taxes and financing charges divided by the sum of financing charges, capitalized interest and cumulative preferred dividends.

³The net asset coverage on long-term debt ratio has been presented as at June 30, 2004 and December 31, 2003 and has been calculated as total assets minus total liabilities excluding long-term debt (including current portion) divided by long-term debt including current portion.

⁴Total debt to capitalization ratio has been presented as at June 30, 2004 and December 31, 2003 and has been calculated as total debt divided by total debt plus total shareholder's equity.

FORWARD LOOKING STATEMENTS AND OTHER INFORMATION

We have included forward looking statements in this report that are subject to risks, uncertainties and assumptions. Such information represents our current views based on information as at the date of this report. We do not intend to update this information and disclaim any legal obligation to the contrary.

This management's discussion and analysis is dated as at August 11, 2004. Additional information about our company, including our annual information form, is available on SEDAR at www.sedar.com.

HYDRO ONE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

<i>(Canadian dollars in millions)</i>	Three months ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Revenues				
Transmission	307	323	629	658
Distribution	655	619	1,435	1,427
Other	4	11	8	15
	<u>966</u>	<u>953</u>	<u>2,072</u>	<u>2,100</u>
Costs				
Purchased power	455	424	995	1,000
Operation, maintenance and administration	222	202	408	384
Depreciation and amortization	115	109	226	208
	<u>792</u>	<u>735</u>	<u>1,629</u>	<u>1,592</u>
Income before financing charges and provision for payments in lieu of corporate income taxes	174	218	443	508
Financing charges	83	88	168	174
Income before provision for payments in lieu of corporate income taxes	91	130	275	334
Provision for payments in lieu of corporate income taxes	26	45	85	110
Net income	<u>65</u>	<u>85</u>	<u>190</u>	<u>224</u>
Basic and fully diluted earnings per common share (Canadian dollars)	<u>602</u>	<u>806</u>	<u>1,810</u>	<u>2,149</u>

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (unaudited)

<i>(Canadian dollars in millions)</i>	Three months ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Retained earnings, beginning of period	699	576	654	502
Net income	65	85	190	224
Dividends (Note 2)	(62)	(60)	(142)	(125)
Retained earnings, end of period	<u>702</u>	<u>601</u>	<u>702</u>	<u>601</u>

See accompanying notes to Consolidated Financial Statements.

HYDRO ONE INC.
CONSOLIDATED BALANCE SHEETS

<i>(Canadian dollars in millions)</i>	June 30, 2004	December 31, 2003
	(unaudited)	
Assets		
Current assets		
Accounts receivable (net of allowance for doubtful accounts)	619	616
Materials and supplies	49	45
	668	661
Fixed assets		
Fixed assets in service	14,572	14,362
Less: accumulated depreciation	5,328	5,175
	9,244	9,187
Construction in progress	380	278
	9,624	9,465
Other long-term assets		
Deferred pension asset	522	584
Regulatory assets	375	421
Goodwill	133	133
Long-term accounts receivable and other assets	16	20
Deferred debt costs	24	22
	1,070	1,180
Total assets	11,362	11,306
Liabilities		
Current liabilities		
Bank indebtedness	10	37
Accounts payable and accrued charges	630	620
Accrued interest	41	38
Short-term notes payable	142	25
Long-term debt payable within one year <i>(Note 3)</i>	200	472
	1,023	1,192
Long-term debt <i>(Note 3)</i>	4,744	4,539
Other long-term liabilities		
Regulatory liabilities	531	584
Employee future benefits other than pension <i>(Note 4)</i>	627	597
Environmental liabilities	65	69
Long-term accounts payable and accrued charges	33	34
	1,256	1,284
Total liabilities	7,023	7,015
Shareholder's equity		
Preferred shares (authorized: unlimited; issued: 12,920,000)	323	323
Common shares (authorized: unlimited; issued: 100,000)	3,314	3,314
Retained earnings	702	654
Total shareholder's equity	4,339	4,291
Total liabilities and shareholder's equity	11,362	11,306

See accompanying notes to Consolidated Financial Statements.

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

<i>(Canadian dollars in millions)</i>	Three months ended June 30		Six months ended June 30	
	2004	2003	2004	2003
Operating activities				
Net income	65	85	190	224
Adjustments for non-cash items:				
Depreciation and amortization (net of removal costs)	104	98	208	193
Amortization of discount	15	17	33	25
Retail settlement variance accounts	7	8	16	14
	191	208	447	456
Changes in non-cash balances related to operations	19	42	37	60
Net cash from operations	210	250	484	516
Financing activities				
Long-term debt:				
Issued	120	750	370	1,250
Retired	(237)	(651)	(472)	(651)
Termination of forward sale	-	(12)	-	(12)
Short-term notes payable	142	77	117	(294)
Dividends paid	(62)	(60)	(142)	(125)
Deferred debt costs	(1)	(3)	(2)	(5)
Net cash (used in) from financing activities	(38)	101	(129)	163
Investing activities				
Fixed assets	(198)	(140)	(345)	(234)
Other assets	16	(1)	17	7
Net cash used in investing activities	(182)	(141)	(328)	(227)
Net change in cash and cash equivalents	(10)	210	27	452
Cash and cash equivalents, beginning of period	-	207	(37)	(35)
Cash and cash equivalents, end of period	(10)	417	(10)	417

See accompanying notes to Consolidated Financial Statements.

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

1. BASIS OF PRESENTATION

The Consolidated Financial Statements of Hydro One Inc. (Hydro One or the Company) which are presented herein have been prepared in accordance with the accounting policies described in the Consolidated Financial Statements for the years ended December 31, 2003 and December 31, 2002, and should be read in conjunction with those financial statements.

In the opinion of management, the unaudited interim Consolidated Financial Statements reflect all of the adjustments, which consist only of normal and recurring adjustments, necessary to present fairly the financial position as at June 30, 2004 and the results of operations and cash flows for the three and six months ended June 30, 2004 and 2003.

2. DIVIDENDS

During the six months ended June 30, 2004, preferred dividends in the amount of \$9 million (2003 - \$9 million) and common dividends in the amount of \$133 million (2003 - \$116 million) were declared.

3. LONG-TERM DEBT

On February 19, 2004, Hydro One issued notes with a principal amount of \$250 million under the Company's medium term note program. The notes were issued in one tranche of Series 7 for \$250 million at a coupon rate of 3.95% due February 24, 2009.

On June 22, 2004, Hydro One issued notes with a principal amount of \$120 million under the Company's medium term note program. These notes, a re-opening of Series 4, have a coupon rate of 6.35% and are due January 31, 2034.

4. EMPLOYEE FUTURE BENEFITS

In accordance with the Ontario Energy Board's (OEB) rate orders, Hydro One recognizes pension costs in the year contributions are paid to the pension fund. During the six months ended June 30, 2004, the Company has accrued approximately \$54 million (2003 - \$nil) in respect of the contributions expected to be made later in the year. Of this amount, \$31 million has been attributed to labour and charged to operations, and \$23 million has been capitalized as part of the cost of fixed assets. During the three months ended June 30, 2004, the Company has accrued approximately \$27 million (2003 - \$nil) in respect of the contributions expected to be made later in the year. Of this amount, \$15 million has been attributed to labour and charged to operations, and \$12 million has been capitalized as part of the cost of fixed assets. No contributions were paid in 2002.

During the six months ended June 30, 2004, the net periodic benefit cost related to employee future benefits other than pension was \$47 million (2003 - \$44 million). During the three months ended June 30, 2004, the net periodic benefit cost related to employee future benefits other than pension was \$19 million (2003 - \$20 million).

HYDRO ONE INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)****5. SEGMENTED REPORTING**

Hydro One has three reportable segments:

- I. The transmission business, which comprises the core business of providing transportation and connection services, is responsible for transmitting electricity throughout the Ontario electricity grid;
- II. The distribution business, which comprises the core business of delivering and selling electricity to customers; and
- III. The "other" segment, which primarily consists of telecommunications.

The designation of segments is 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:

<i>Three months ended June 30 (Canadian dollars in millions)</i>	Transmission	Distribution	Other	Consolidated
2004				
Segment profit				
Revenues	307	655	4	966
Purchased power	-	455	-	455
Operation, maintenance and administration	103	113	6	222
Depreciation and amortization	58	56	1	115
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes				
	146	31	(3)	174
Financing charges				83
Income before provision for payments in lieu of corporate income taxes				
				91
Capital expenditures	117	79	2	198
2003				
Segment profit				
Revenues	323	619	11	953
Purchased power	-	424	-	424
Operation, maintenance and administration	95	99	8	202
Depreciation and amortization	56	52	1	109
Income before financing charges and provision for payments in lieu of corporate income taxes				
	172	44	2	218
Financing charges				88
Income before provision for payments in lieu of corporate income taxes				
				130
Capital expenditures	64	72	4	140

HYDRO ONE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

<i>Six months ended June 30 (Canadian dollars in millions)</i>	Transmission	Distribution	Other	Consolidated
2004				
Segment profit				
Revenues	629	1,435	8	2,072
Purchased power	-	995	-	995
Operation, maintenance and administration	188	210	10	408
Depreciation and amortization	115	109	2	226
Income (loss) before financing charges and provision for payments in lieu of corporate income taxes				
	326	121	(4)	443
Financing charges				168
Income before provision for payments in lieu of corporate income taxes				
				275
Capital expenditures	198	143	4	345
2003				
Segment profit				
Revenues	658	1,427	15	2,100
Purchased power	-	1,000	-	1,000
Operation, maintenance and administration	189	181	14	384
Depreciation and amortization	108	99	1	208
Income before financing charges and provision for payments in lieu of corporate income taxes				
	361	147	-	508
Financing charges				174
Income before provision for payments in lieu of corporate income taxes				
				334
Capital expenditures	112	114	8	234
<i>(Canadian dollars in millions)</i>				
			June 30, 2004	December 31, 2003
Total assets				
Transmission			6,646	6,589
Distribution			4,617	4,623
Other			99	94
			11,362	11,306

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

6. SUBSEQUENT EVENTS

Pension

On June 1, 2004, Hydro One filed an application with the OEB requesting approval for the establishment of a regulatory deferral account effective January 1, 2004 to record cash pension costs and interest thereon in relation to the distribution business and confirmation of the prudence of the pension costs. The application proposed an interim rate mechanism to allow recovery of these pension costs commencing March 1, 2005.

On July 14, 2004, the OEB issued an order approving the establishment of a regulatory deferral account to record cash payments related to distribution pension costs and interest thereon. The OEB noted in its decision that it would not rule on the prudence of these costs at this time but that prudently incurred costs of this type are normally recoverable as part of a general rate adjustment application. Given the OEB's order, we have determined that it is appropriate, in the third quarter, to reflect approximately \$16 million of distribution pension costs previously expensed this year, as well as future distribution pension costs covered by the OEB's order, as a regulatory asset.

HYDRO ONE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited) (continued)

On August 11, 2004, Hydro One's Board of Directors approved a new actuarial valuation report to be submitted to the Financial Services Commission of Ontario in September. The report sets the required funding for each of 2004, 2005 and 2006 at about \$80 million per year. The reduction from the previous estimate of \$100 million primarily reflects the better than planned investment performance of the pension fund during 2003.

Electricity Meters

On July 14, 2004, the Minister of Energy issued a directive to the OEB under the *Ontario Energy Board Act, 1998*, as approved by Order in Council on June 23, 2004. The directive requires the OEB to develop and implement a plan to achieve the Government's objectives for the implementation of smart electricity meters to manage demand, make more efficient use of current supply and reduce reliance on external sources. The OEB is to provide the implementation plan to the Minister of Energy by February 15, 2005.

The Government is targeting the installation of 800,000 smart meters by December 31, 2007, and installation of smart meters for all Ontario customers by December 31, 2010. While the details of the program are not currently available, Hydro One's preliminary estimate of the impact of this directive is capital investments in the range of \$400 million to \$600 million, and annual operating costs reaching about \$20 million, by 2009. Hydro One anticipates that these costs will be recoverable through future rates.

7. COMPARATIVE FIGURES

The comparative Consolidated Financial Statements have been reclassified from statements previously presented to conform to the presentation of the June 30, 2004 Consolidated Financial Statements.