

**PLUTONIC POWER CORPORATION**

**FISCAL YEAR ENDED DECEMBER 31, 2007**

**Management's Discussion & Analysis**

Suite 600 – 888 Dunsmuir Street, Vancouver BC, V6C 3K4  
Tel: (604) 669-4999 Fax: (604) 682-3727  
[www.plutonic.ca](http://www.plutonic.ca)

## **INTRODUCTION**

This Management's Discussion and Analysis ("MD&A") includes financial information from, and should be read in conjunction with, the audited consolidated financial statements of Plutonic Power Corporation ("Plutonic" or "the Company") for the fiscal year ended December 31, 2007. The Company reports its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles ("GAAP") in Canadian dollars. This MD&A was prepared with information available as of March 10, 2008. Additional information and disclosure relating to the Company can be found on SEDAR at [www.sedar.com](http://www.sedar.com)

## **FORWARD-LOOKING STATEMENTS**

Certain statements contained in this MD&A constitute forward-looking statements. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "designed", "expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements are subject to a variety of risks and uncertainties which could cause actual events or results to differ from those reflected in the forward-looking statements. Based on current available information, the Company believes that the expectations reflected in those forward-looking statements are reasonable, but no assurance can be given that those expectations will prove to be correct. The forward-looking statements in this MD&A are expressly qualified by this statement, and readers are advised not to place undue reliance on the forward-looking statements.

## **OVERVIEW**

Plutonic Power Corporation and its wholly owned subsidiary companies, Plutonic Hydro Inc., Plutonic TMP Holdings Inc., and Upper Toba Hydro Inc., are incorporated in the Province of British Columbia, Canada. The Company is a reporting issuer in British Columbia, Alberta, and Ontario and its common shares trade on the Toronto Stock Exchange ("TSX") under the symbol PCC.

The Company's principal business activities are the identification, development, construction and ultimately, the operation of economically viable clean power projects. The Company has a current portfolio of 29 run-of-river hydroelectric sites ("Power Sites") in British Columbia with two Power Sites under construction and the remaining 27 Power Sites at various stages of permitting and development. The Company is focused on a growth and development path to become a leading supplier of clean electricity in Canada.

The Company's 29 Power Sites have a total potential design capacity of approximately 1,600 megawatts ("MW") with the potential to generate approximately 5,300 gigawatt hours ("GWh") of electricity annually.

During 2007, the Company and its partner GE Energy Financial Services Holding Company ("GE") formed Toba Montrose General Partnership ("TMGP"), a general partnership formed under the laws of the Province of British Columbia, to finance, build and operate the 196 MW East Toba River and Montrose Creek run-of-river generation facilities, including approximately 150 km of transmission line to connect these two generation facilities to British Columbia Transmission Corporation's substation at Saltery Bay. During the fourth quarter of 2007, the Company and GE made their respective partners' contributions, arranged the required project debt financing and guarantees which totalled approximately \$660 million and construction of the Toba Montrose project under the terms of TMGP's Engineering, Procurement and Construction ("EPC") contract with its contractor Peter Kiewit Sons Co. ("Kiewit") with scheduled completion of the project in 2010. These two generation facilities are to have a combined capacity of 196 MW and are to generate on average 745 GWh of electricity annually. Commencement of delivery and sale of electricity to the British Columbia Hydro and Power Authority ("BC Hydro"), a provincial Crown Corporation is to begin in 2010 under a 35-year Electricity Purchase Agreement ("EPA").

## **OUTLOOK**

The Company continues to conduct engineering and hydrological studies, consult with First Nations, local communities and other stakeholders, proceed with permitting and perform other required studies on its remaining 27 run-of-river sites in British Columbia. The Company intends to submit the three Upper Toba Valley projects, some

or all of its eighteen Bute Inlet projects, the Europa project and possibly the Freda Creek project into the next BC Hydro Call for Tender (“CFT”), anticipated to be formally unveiled by BC Hydro during 2008.

The Company intends to complete the permitting for the Upper Toba Valley Project and obtain an environmental assessment certificate in early 2009 and obtain the required project financing to allow for commencement of construction during 2009. The Company intends to complete the Bute projects permitting requirements by the end of 2010 and obtain the required project financing to allow for commencement of construction in 2011.

The Company continues to evaluate other potential clean hydro power projects to add to its growing portfolio. The long term outlook for run of river hydro project development in British Columbia remains promising. Government policy on electricity, the environment and First Nations have come together to create a perfect framework for the Plutonic business plan.

Plutonic has assembled a team of qualified professionals and support staff who are capable of advancing the Company’s projects and continue its future growth.

## **PROJECT UPDATES**

### **East Toba River and Montrose Creek Project (Green Power Corridor)**

The East Toba River and Montrose Creek (“Toba/Montrose”) run-of-river power projects are located in the Toba Valley in British Columbia. The combined designed capacity is 196 MW with expected annual average electricity generation of 745 GWh.

During 2007, the Company transferred to TMGP its Toba and Montrose project, its EPA with BC Hydro, and the related rights, benefits and obligations in its Impact Benefits Agreements with the Klahoose First Nation (“Klahoose”) and Sliammon First Nation (“Sliammon”). For further information, see Investment in Toba Montrose General Partnership below.

In 2006, the Company submitted a tender into the 2006 BC Hydro CFT. BC Hydro subsequently awarded the Company an EPA for the Toba/Montrose project for the supply of 745 GWh of electricity per year for 35 years beginning in 2010. This EPA was subsequently approved by the BC Utilities Commission in October of that year.

Prior to TMGP entering into a construction contract with Kiewit, the Company had, since November 2006, engaged Kiewit on a limited notice to proceed contract, and had funded final project engineering, the purchase of a number of pre-fabricated bridges, materials for a construction camp and the commencement of construction on 60 km of access roads and 11 bridges and related infrastructure to access and build the generation facilities. The limited notice to proceed contract was entered into in order to maintain a construction schedule to allow the project to commence commercial operations in 2010. During 2007, TMGP reimbursed the Company, at cost, \$31.4 million in project expenditures previously funded by the Company.

In February 2007, the Company and the Klahoose First Nation finalized an Impact Benefits Agreement (“Klahoose IBA”) which facilitated Klahoose support for the development of the Toba/Montrose power project which is located within the Traditional Territory of the Klahoose First Nation. The Klahoose IBA establishes terms under which the Klahoose First Nation supports and endorses the development of the project. The Klahoose First Nation Chief and Council gave their support for the construction and operation of the project within their Traditional Territory and the Klahoose membership ratified the Klahoose IBA during a series of meetings with unanimous support by all voting members. The Klahoose IBA includes specific terms for future agreements between the Company and the Klahoose First Nation on other run-of-river projects that the Company may wish to develop within the Toba River Valley area of Klahoose First Nation Traditional Territory.

The Klahoose IBA also includes:

- Ongoing respect by the Company for asserted aboriginal rights and title by the Klahoose First Nation in the area
- Payment of access fees to the Klahoose First Nation during project construction of the Toba/Montrose project

- Revenue sharing payments to the Klahoose First Nation during the term of the EPA
- Annual royalty payments to the Klahoose First Nation in operating years after the term of EPA for the remainder of the Toba/Montrose project's life
- Employment, training and contracting opportunities for Klahoose First Nation members

In April 2007, the Company and the Sliammon First Nation finalized an IBA ("Sliammon IBA") which facilitated Sliammon First Nation support for the development of the Toba/Montrose power project. A significant portion of the transmission line that will link the Toba/Montrose generation facilities to the British Columbia Transmission Corporation ("BCTC") grid will be located within Sliammon First Nation Traditional Territory. The Sliammon IBA establishes terms under which the Sliammon First Nation supports and endorses the development of the project. The Company recognizes and respects Sliammon First Nation assertion of aboriginal title and rights, archaeological sites and artefacts and Sliammon First Nation traditional use in the area.

The Sliammon IBA also includes:

- Ongoing respect by the Company for asserted aboriginal rights and title by the Sliammon First Nation in the area
- Payment of access fees to the Sliammon First Nation during project construction of the Toba/Montrose project
- Revenue sharing payments to the Sliammon First Nation during the term of the EPA
- Annual royalty payments to the Sliammon First Nation in operating years after the term of EPA for the remainder of the Toba/Montrose project's life
- Employment, training and contracting opportunities for Sliammon First Nation members

Subsequent to December 31, 2007, the Company, TMGP and the Sechelt First Nation signed an IBA to facilitate Sechelt First Nation support for the development of the transmission infrastructure and the Saltery Bay substation for the Toba/Montrose project within the Traditional Territory of the Sechelt First Nation. The IBA also outlines how the Company and the Sechelt First Nation will work together on future project development. With the signing of this agreement, the Sechelt First Nation, Chief and Council, have given their support for Toba/Montrose project and other Plutonic future projects, subject to receiving environmental permitting.

The Sechelt IBA also includes:

- Ongoing respect by the Company for asserted aboriginal rights and title by the Sechelt First Nation in the area
- Payment of access fees to the Sechelt First Nation during project construction of the Toba/Montrose project
- Revenue sharing payments to the Sechelt First Nation during the term of the EPA
- Annual royalty payments to the Sechelt First Nation in operating years after the term of EPA for the remainder of the Toba/Montrose project's life
- Employment, training and contracting opportunities for Sechelt First Nation members

During 2007, the Integrated Land Management Bureau and the British Columbia Ministry of the Environment granted land tenures and water licenses for the Toba/Montrose project sites, roads, and transmission line. Fisheries and Oceans Canada, Indian and Northern Affairs Canada and Transport Canada rendered positive decisions in their environmental screening report after their screening level review under the Canadian Environmental Assessment Act, and the British Columbia Environmental Assessment Office ("EAO") granted the Provincial Environmental Certification to this project.

During 2007, the Company applied on behalf of TMGP for an incentive of one cent per kilowatt-hour for up to 10 years to eligible low-impact, renewable electricity projects constructed over the next four years from April 1, 2007 to March 31, 2011 from ecoENERGY, a Canadian federal government program to encourage construction of renewable and green projects. The Company has been notified that the project has passed basic qualification criteria and they are currently reviewing the environmental assessment documents as part of the application review process.

## **Investment in Toba Montrose General Partnership**

In 2007, the Company and GE formed TMGP to finance, build and operate the Toba/Montrose run-of-river power project.

The Company transferred to TMGP the Toba/Montrose project and associated permits, licences, IBA's with the Klahoose and Sliammon First Nations and its EPA with BC Hydro. In return, the Company received and holds a 51% non-participating and voting interest and a 40% economic interest in TMGP. After 35 years of operations, the Company's economic interest in TMGP will increase from 40% to 51%. The Company accounts of its investment in TMGP using the proportionate method of consolidation whereby the Company records its 40% share of assets, liabilities, revenues and expenses of TMGP.

The Company is required to contribute \$30 million in equity on or before the earlier of the date TMGP's senior debt facilities have been fully drawn and November 1, 2010. The additional \$30 million equity contribution in TMGP is primarily to fund an increase in capacity of the 230 kilovolt transmission line to be built from the Toba Valley to Saltery Bay, British Columbia. The Company will have the right to use, subject to a priority use agreement, any additional unused capacity of the transmission line for its three additional Upper Toba Valley sites. An affiliate of GE provided a \$30 million guarantee to TMGP senior debt lenders in respect of the Company's \$30 million equity contribution in 2010. In return, the Company granted GE the right to negotiate financing on up to an additional 200 MW of other hydroelectric power projects of the Company in British Columbia and issued to the GE affiliate 650,000 two year common share purchase warrants of the Company with an exercise price of \$9.03 per common share. The Company pays the GE affiliate a 3% per annum fee on the amount of guarantee provided.

The obligations of TMGP are non-recourse to the Company.

## **Toba Montrose General Partnership**

On October 26, 2007, GE, through an affiliate, provided a \$100 million equity bridge loan to TMGP. On commencement of commercial operations, which is expected to occur in 2010, GE will invest \$100 million of equity in TMGP which will be used to repay the \$100 million equity bridge loan. TMGP pays interest to the GE affiliate on the equity bridge loan with a cumulative maximum amount of \$15 million payable during construction. In return, GE received and holds a 49% non-participating and voting interest and a 60% economic interest in TMGP. After 35 years of operations, GE's economic interest in TMGP will decrease from 60% to 49%. As at December 31, 2007, TMGP had drawn \$95.6 million under the GE equity bridge loan.

TMGP engaged GE Capital Markets (Canada), Ltd., an affiliate of GE, and the Manufacturers Life Insurance Company as co-leads to arrange the required project debt financing. The co-agents led a syndicate of financial institutions to provide TMGP with a \$370 million fixed rate credit facility and a \$100 million floating rate credit facility, for a total of \$470 million in project debt financing. The 38-year senior secured credit facilities have draw downs to correspond with the three-year construction period and are to be repaid over the 35-year term of the project's EPA with BC Hydro. These credit facilities are secured by TMGP's assets. As at December 31, 2007, the debt providers had advanced \$20.2 million of the \$470 million credit facilities. Concurrently with the closing of the floating rate facility, TMGP entered into two interest rate swap contracts, one for the estimated term of the construction period and one for the estimated operating term.

TMGP has executed a \$497 million fixed-price EPC contract with Kiewit for the construction of this project. As at December 31, 2007, TMGP had incurred \$75.4 million under the Kiewit EPC contract.

A GE affiliate has provided \$28 million of contingent equity and debt service reserve guarantees during construction of the project and \$8 million of contingent debt service reserve guarantee to TMGP debt providers during operations. TMGP is required to pay to the GE affiliate a 3% per annum fee on the amount of guarantees provided. If required, the Company and GE would be required to fund their pro-rata share of project cost overruns, if any.

A GE affiliate provided an \$11.76 million letter of credit to BC Hydro as part of the EPA performance bonding requirements. TMGP is required to pay to the GE affiliate a 3% per annum fee on the face amount of the letter of credit.

### **Upper Toba Valley Project (Green Power Corridor)**

The Upper Toba Valley Project, with three Power Sites, has combined potential capacity of 120 MW and potential annual electricity generation of 466 GWh. These three Power Sites are located near the headwaters of Toba Inlet, approximately 100 km north of Powell River, BC and were added to the Company's portfolio during 2007.

During 2007, the Company successfully completed Stages one and two towards securing a Water License and Crown Land rights from the Integrated Land Management Bureau (Ministry of Agriculture and Lands) ("ILMB") and the Water Stewardship Division (Ministry of the Environment) ("MOE") for these three Power Sites. The Company submitted the Upper Toba Valley project to the EAO for the construction of three run-of-river generation facilities, one each of which is located on Dalgleish Creek, Jimmie Creek and the Upper Toba River. The EAO issued a Section 10 order that binds the Upper Toba Valley project to the Environmental Assessment Act and a Section 11 order that sets the process the environmental assessment must follow.

The Company has the right to use any additional unused capacity of the transmission line being built for TMGP for the Company's wholly owned three additional Upper Toba Valley Power Sites.

As a provision in the IBA with the Klahoose First Nation, in the event the Company obtains an EPA for the Upper Toba Valley project, Klahoose First Nation extends their support for the development of this project.

### **Bute Inlet Project (Green Power Corridor)**

The Bute Inlet Project, encompassing eighteen Power Sites, has a combined potential capacity of 912 MW and potential annual electricity generation of 2,979 GWh. Nine of these eighteen Power Sites were added during 2007.

The Company successfully completed Stages one and two towards securing a Water License and Crown Land rights from the Integrated Land Management Bureau (Ministry of Agriculture and Lands) and the Water Stewardship Division (Ministry of the Environment) for all of the new Power Sites added in 2007.

### **Knight Inlet Power Sites- Green Power Corridor**

The Knight Inlet area, with 3 Power Sites, has a combined potential capacity of 152 MW and potential annual electricity generation of 451 GWh. The Company continues to conduct engineering and hydrological studies, consult with First Nations, community and other stakeholders, proceed with permitting and perform other required studies

### **Europa Project**

In April 2005, the Company successfully completed Stages 1 and 2 towards securing a Water License and Crown Land rights from MOE and ILMB for this project.

In April 2006, the Company submitted the Europa Creek project into the British Columbia Environmental Assessment Permitting Process, with the EAO consequently issuing a Section 10 order binding the project to the *Environmental Assessment Act*.

### **Freda Project**

In August 2005, the Company successfully completed Stages 1 and 2 towards securing a Water License and Crown Land rights from MOE and ILMB for the development of this project.

Since 2005, the Company has been collecting hydrological data in order to better define the water resource at Freda Creek.

## Rainy River and Hope projects

The Rainy River power project is located near Gibsons, British Columbia. The designed capacity is 14 MW with an expected annual average electricity generation of approximately 50 GWh. The Hope Power Sites are located near Hope, British Columbia and they have a combined base capacity of 37 MW and potential base annual average electricity generation of 133 GWh.

In 2006, the Company entered the Rainy River and one of the Hope power project into the 2006 BC Hydro Call for Tender. BC Hydro awarded the Company a 35 year EPA for the Rainy River. In August 2007, the Company advised BC Hydro of its intention to exit the EPA for the 14 MW Rainy River project due to unexpected complexities in the environmental permitting process caused by the discovery of a number of fish species in the area. Complexities in permitting have decreased certainty around the timing for the project commercial operation date. The Company paid a cancellation fee of \$100,662 to BC Hydro and received \$900,000 of performance security deposit back from its bank when the associated letter of credit that had been posted as a performance bond was released by BC Hydro.

Subsequent to December 31, 2007, the Company sold the Rainy River and Hope Power Sites to AltaGas Income Trust ("AltaGas") and received 180,433 special purchase warrants of AltaGas with each warrant entitling the Company to receive one fully paid Altagas trust unit on January 1, 2010 at no additional cost. The Company valued these restricted warrants at its fair value using a Black-Scholes option pricing model and as a result, the Company wrote down the amount of development costs recorded for the Rainy River and Hope Power Sites to their fair value at year-end.

## SELECTED FINANCIAL INFORMATION

Fiscal Year ended	December 31, 2007	December 31, 2006	December 31, 2005
Total Revenue	Nil	Nil	Nil
Loss before Extraordinary Items	\$10,644,912	\$1,193,567	\$883,422
Net Loss for the Period	\$10,644,912	\$1,193,567	\$883,422
Loss Per Share Basis	\$0.29	\$0.06	\$0.07
Loss Per Diluted Share Basis	\$0.29	\$0.06	\$0.07
Total Assets	\$110,649,946	\$29,822,638	\$4,017,568
Total Long-Term Liabilities	\$29,454,455	Nil	Nil
Cash Dividends per Share	Nil	Nil	Nil
Number of Shares Issued and Outstanding	40,413,993	30,455,002	12,684,982

## RESULTS OF OPERATIONS

### Fiscal Year ended December 31, 2007, compared to the fiscal year ended December 31, 2006

The Company recorded a net loss of \$10,644,912 for the fiscal year ended December 31, 2007 (\$0.29 loss per share) compared to a net loss of \$1,193,567 (\$0.06 per share) in fiscal year 2006, an increase in net loss of \$9,451,345. The Company recorded its share of \$2,896,965 in TMGP losses in 2007 compared to nil in 2006, increased salaries and operating costs in 2007 to support the increase in development of its run-of-river power projects, increased the number of officers, managers and administrative staff, in preparation for construction and financing of its East Toba and Montrose project, increased advertising and general travel, and recorded a higher fair value of stock options granted and vested.

Share-based compensation expense was \$3,785,883 in 2007 compared to \$446,994 in 2006, an increase of \$3,338,889. The Company recorded a higher number of vested options with a higher fair value in 2007 compared to 2006.

During the year ended December 31, 2007, the Company recorded its 40% share of TMGP's loss on the fair value adjustment of interest rate swap contracts of \$2,881,176 compared to nil in 2006. TMGP entered into interest rate swap contracts related to its \$100 million floating rate credit facility. That \$100 million credit facility is to be drawn during the three year construction phase and it will be repaid during the operating term of 35 years. TMGP records changes in the fair value of these interest rate swap contracts to earnings. TMGP has entered into these interest rate swap contracts to fix the rate of interest that will be paid over the term of the floating rate credit facility.

Salaries expense and management fees were \$2,463,816 in 2007 compared to \$831,692 in 2006, an increase of \$1,632,124. The Company increased the number of officers, managers and administrative staff in 2007 to meet the growth of the Company and its project development activities. The CEO's salary was recorded under salaries in 2007 and in management fees in 2006.

The Company paid a cancellation fee of \$100,662 in 2007 to terminate its Rainy River EPA with BC Hydro. Subsequent to December 31, 2007, the Company sold the Rainy River and Hope Power Sites to AltaGas. At the end of 2007, the carrying value of the Hope and Rainy River Power Sites was written down by \$418,143 to their recoverable value (see Rainy River and Hope projects under Project updates).

The Company recorded \$228,172 of guarantee fees during the year ended December 31, 2007. The Company pays a 3% credit fee to an affiliate of GE for the \$30 million letter of credit GE has posted on behalf of the Company to TMGP lenders to guarantee the \$30 million equity contribution the Company is required make in TMGP no later than November 1, 2010. The Company is also amortizing the fair value of the 650,000 warrants issued by the Company to GE as part the transaction over the term of the guarantee.

Consulting fees, office costs rent, professional fees and travel and promotion all increased to support the Company's increased development of its run-of-river power projects, the increased number of power projects under development and to support financing of the Company's working capital and project development costs.

The Company spent \$117,150 on project evaluation in and wrote off \$40,144 of power project development costs (excluding the write down of the Rainy River and Hope projects) in 2007, an increase of \$142,060 compared to 2006 as the Company expands its evaluation of potential future clean power projects.

Interest income was \$1,187,935 in 2007 compared to \$208,188 in 2006, an increase of \$979,747 due to higher average cash balances on hand.

Excluding Toba/Montrose project expenditures, the Company incurred \$6,763,201 of costs associated with its Power Sites for on-going engineering and hydrological work, meeting regulatory and permitting requirements, as well as First Nations, community and other stakeholder consultations. For Toba/Montrose during 2007 and prior to the formation of TMGP and its financing, the Company had engaged Kiewit on a limited notice to complete final project engineering, materials for a construction camp and commencement of construction of 60 kilometres of access roads and 11 bridges and related infrastructure to access and build the generation facilities. On completion of project financing by TMGP, TMGP reimbursed the Company \$31,394,065 at cost.

## SUMMARY OF QUARTERLY RESULTS

The following table summarizes information regarding the Company's operations on a quarterly basis for the last eight quarters.

Quarter Ended	Revenue	Loss	Loss Per Share	Loss Per Diluted Share
31-Dec-07	\$0.00	\$6,202,015	\$0.17	\$0.17
30-Sep-07	\$0.00	\$1,082,306	\$0.03	\$0.03
30-Jun-07	\$0.00	\$2,704,232	\$0.07	\$0.07
31-Mar-07	\$0.00	\$656,359	\$0.02	\$0.02

Quarter Ended	Revenue	Loss	Loss Per Share	Loss Per Diluted Share
31-Dec-06	\$0.00	\$117,595	\$0.01	\$0.01
30-Sep-06	\$0.00	\$489,659	\$0.03	\$0.03
30-Jun-06	\$0.00	\$376,090	\$0.02	\$0.02
31-Mar-06	\$0.00	\$210,223	\$0.02	\$0.02

Operating costs and stock based compensation costs have been increasing with the growth of the Company and issuance of a higher number of stock options with a higher fair value. The Company's proportionate interest in the change in fair value of TMGP's interest rate swap contracts (a non cash item) may cause significant fluctuations in earnings from quarter to quarter.

#### **FOURTH QUARTER 2007**

The Company incurred a loss of \$6,202,015 during the fourth quarter of 2007. The major items incurred in Q4-2007 were as follows:

The Company contributed its Toba/Montrose assets to TMGP during the fourth quarter of 2006 and began to proportionally consolidate its 40% interest in TMGP. The Company's 40% share of TMGP's loss during the fourth quarter was \$2,881,176, primarily from TMGP's fair value adjustment of interest rate swap contracts.

Salaries expense was \$1,540,112 and included 2007 bonuses.

Share based compensation expense recorded was \$992,969 for the options vested during Q4-2007 of which a large number had high fair values.

The Company wrote off \$319,266 in power project development costs, primarily from the write down of the Rainy and Hope power projects to their recoverable amount.

The above expenses were offset by \$459,885 in interest income and the gain from the sale of marketable securities.

With the inclusion of the Company's 40% share of TMGP's assets increased by \$38.9 million, short term and long term liabilities increased by \$25.3 million and the Company recorded a non-controlling interest of \$15.9 million.

#### **LIQUIDITY AND CAPITAL RESOURCES**

The Company had working capital of \$42,339,540 as at December 31, 2007 compared to working capital of \$3,954,409 as at December 31, 2006, an increase of \$38,385,131. As at December 31, 2007, the Company's proportionate share of restricted cash held in escrow to fund the construction of the Toba/Montrose project was \$8,073,186.

During 2007, the Company incurred development expenditures of \$34,603,903 on developing its hydroelectric run-of-river projects, recovered \$31,394,065 from TMGP, incurred its proportionate share of additions to property, plant and equipment and intangibles for the current construction of Toba/Montrose, being \$24,637,135, and \$3,409,175 on operating costs. An affiliate of GE posted on behalf of TMGP the required \$11.76 million letter of credit under the BC Hydro EPA requirement for the Toba/Montrose project and the Company was refunded a net amount of \$10 million in security deposits. The Company recorded its proportionate share of TMGP's long term debt, being \$8,061,910, with most of the funds sitting in a restricted account pending required payments for Toba/Montrose construction and related costs. Additionally, GE, as required under the equity bridge financing, funded TMGP an additional \$25,132,753 in excess of its pro-rata share of funding.

On April 18, 2007, the Company closed a \$32,305,000 bought deal private placement equity financing co-led by Orion Securities Inc. and Cormark Securities Inc. and including Scotia Capital Inc. and Toll Cross Securities Inc.

and sold 7,100,000 common shares of the Company at \$4.55 per common share. The Company received \$30,404,280 net of the underwriters commission of \$1,776,775 (5.5% on gross cash proceeds) and other share issue costs.

Excluding the TMGP project financing disclosed below, the Company's source of financing to date has been from the sale or issuance of common shares from treasury.

### TMGP financing

During 2007, TMGP engaged GE Capital Markets (Canada), Ltd., an affiliate of GE, and the Manufacturers Life Insurance Company as co-lead to arrange the required project debt financing. The co-agents led a syndicate of financial institutions to provide TMGP with the following:

- a \$370 million, 38-year, senior secured credit facility with a fixed interest rate, a fixed draw down schedule to correspond with the three-year construction period and a repayment period over the 35-year term of the project's EPA with BC Hydro. The interest rate on this credit facility is 6.288% per annum during construction and 6.173% thereafter. As at December 31, 2007, the lenders had funded \$20.2 million under this credit facility of which the Company's proportionate share is \$8.1 million.
- a \$100 million, 38-year, senior secured credit facility with floating interest rate, flexible draw downs during the three-year construction period and a repayment period over the 35-year term of the project's EPA with BC Hydro. The interest rate on this credit facility is based on one month Canadian dollar bankers' acceptance rates during construction and three months Canadian dollar banker's acceptance rates thereafter, plus an applicable credit spread in each instance. The credit spread is 1.35% per annum during the construction period and for the first four years thereafter, and 1.60% for the remaining term of the credit facility. As at December 31, 2007, TMGP had not yet drawn from this credit facility. Concurrently with the closing of this floating rate credit facility, TMGP entered into two interest rate swap contracts, one for the estimated term of the construction period and one for the estimated operating term.

TMGP paid an upfront fee to the co-lead arrangers and lenders of \$4.7 million on closing of the credit facilities. A commitment fee, equal to 0.375% per annum multiplied by the amount not drawn on the \$470 million in total available credit, is charged and paid to the lenders on a monthly basis during the construction period until fully drawn.

GE, through an affiliate, provided a \$100 million equity bridge loan to TMGP. On commencement of commercial operations, which is expected to occur in 2010, GE will invest \$100 million of equity in TMGP which will be used to repay the \$100 million equity bridge loan. TMGP pays interest to the GE affiliate on the equity bridge loan with a cumulative maximum amount of \$15 million payable during construction. As at December 31, 2007, TMGP had drawn \$95.6 million under the equity bridge loan.

### **CONTRACTUAL OBLIGATIONS**

During 2006, the Company executed two EPAs with BC Hydro to supply 745 GWh and 50 GWh per year of electricity to be generated from the East Toba and Montrose project and the Rainy River project respectively beginning in July 2010 for 35 years. In August 2007, the Company advised BC Hydro of its intention to exit the EPA for the 14 MW Rainy River run-of-river project due to unexpected complexities in the environmental permitting process caused by the discovery of a number of fish species in the area. The Company paid a cancellation fee of \$100,662 to BC Hydro and received \$900,000 of performance security deposit back from BC Hydro.

The Company is required to contribute \$30 million in equity on or before the earlier of the date TMGP's senior debt facilities have been fully drawn and November 1, 2010. The additional \$30 million equity contribution in TMGP is primarily to fund an increase in capacity of the 230 kilovolt transmission line to be built from the Toba Valley to Saltery Bay, British Columbia. The Company will have the right to use, subject to a priority use agreement, any additional unused capacity of the transmission line for its three additional Upper Toba Valley sites. An affiliate of GE provided a \$30 million contingent equity guarantee to TMGP senior debt lenders to support the Company's \$30

million equity contribution in 2010. The Company pays the GE affiliate a 3% per annum fee on the amount of guarantee provided.

In connection with the purchase of Plutonic Hydro Inc. in 2003, the Company is required to pay a one time bonus within 30 days of the later of securing construction financing and the commencement of construction on certain of its power projects. The bonus, payable in shares or cash at the Company's option, is to be calculated as \$1,000 per GWh of electricity per year to be generated on each of these projects. During 2007, the Company paid a bonus of approximately \$745,000 relating to the East Toba and Montrose project.

The Company has no other material contractual obligations for the next five years. The Company is, however, required to carry on the development work to maintain its rights to the power projects. The Company can elect to abandon its power projects and in such instances, the Company would then no longer be required to fund any additional development costs.

#### TMGP Obligations

The obligations of TMGP, including from the contracts, permits, licences and IBAs transferred from the Company, are non-recourse to the Company.

During 2007, the Company transferred to TMGP the East Toba and Montrose project and associated permits, licences, IBA with the Klahoose and Sliammon First Nations and its EPA with BC Hydro. These IBA's include financial commitments with respect to signing bonuses, construction access fees, continued access fees, project and training opportunities, and royalty payments.

The Company received an Environmental Assessment Certificate from the EAO for the Toba/Montrose project in April 2007. This certificate contains a number of commitments that the Company must implement throughout various phases of the project which include mitigation measures to protect wildlife and areas of cultural significance to the Klahoose, Sliammon and Sechelt First Nations. During 2007, the Company transferred this certificate and commitments to the Toba Montrose General Partnership.

TMGP engaged GE Capital Markets (Canada), Ltd., an affiliate of GE, and the Manufacturers Life Insurance Company as co-lead to arrange the required project debt financing. The co-agents led a syndicate of financial institutions to provide TMGP with \$470 million of 38-year senior secured credit facilities with draw downs to correspond with the three-year construction period and repayment over the 35-year term of the project's EPA with BC Hydro. These credit facilities are secured by TMGP's assets. As at December 31, 2007, the debt providers had advanced \$20.2 million of the \$470 million credit facilities.

TMGP executed a \$497 million fixed-price EPC contract with Kiewit for the construction of Toba/Montrose. As at December 31, 2007, TMGP had incurred \$75.4 million under the Kiewit EPC contract.

A GE affiliate provided \$28 million of contingent equity and debt service reserve guarantees during construction of the project and \$8 million of contingent debt service reserve guarantee to TMGP debt providers during operations. TMGP is required to pay to the GE affiliate a 3% per annum fee on the amount of guarantees provided. If required, the Company and GE would be required to fund its pro-rata share of project cost overruns, if any.

A GE affiliate provided an \$11.76 million letter of credit to BC Hydro as part of the EPA performance bonding requirements. TMGP is required to pay to the GE affiliate a 3% per annum fee on the face amount of the letter of credit.

	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Long -term debt used	\$8.1 million	-	-	\$7.3 million	\$0.8 million
Long-term debt to be (drawn) repaid	(\$179.9 million)	(\$88.8 million)	(\$91.1 million)	\$7.3 million	\$172.6 million
Purchase Obligations	\$168.8 million	\$79.3 million	\$89.5 million	-	-

The long-term debt drawn and long-term debt available to be drawn and purchase obligations represent the Company's proportionate interest of 40% in TMGP.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

In 2006, GE provided the Company with a \$2,500,000 letter of credit to partly finance the issuance of \$12,660,000 in letters of credit required as performance security for the Toba/Montrose and Rainy River EPA. The Company deposited \$10,160,000 to provide the remaining letter of credit support. The Company was required to pay to GE interest on the \$2,500,000 of credit support provided to the Company at an annual rate of 10% for the first 60-day period and an annual rate of 12% thereafter until the letter of credit is cancelled or no longer required. During 2007, TMGP assumed the bonding requirements of the Toba Montrose EPA and the Company retired the \$2,500,000 GE letter of credit and paid the accrued interest on the loan. The Company does not have any other off-balance sheet arrangements.

#### **TRANSACTIONS WITH RELATED PARTIES**

Until December 31, 2007 substantially all of the Company's administrative operations had been performed by a private company owned by the President of the Company. This related private company charged fees of \$54,630 (2006 - \$402,563) for these services during 2007 and was owed \$14,631 (2006 - \$64,001) at December 31, 2007. The Company also purchased a used vehicle and office furniture and equipment from this related private company in the amount of \$10,000 and \$9,935 respectively. The amounts owed to this related company are non-interest bearing. The activities under this arrangement ceased as of December 31, 2007.

During 2007, the Company paid or accrued \$551,039 (2006 - \$278,093) in legal fees to a law firm, of which a partner is the corporate secretary of the Company and this law firm was owed \$2,252 (2006 - \$21,183) at December 31, 2007. The activities under this arrangement ceased as of December 31, 2007.

The Company provides to TMGP on-going office administration services on a cost recovery basis. As of December 31, 2007, the Company was owed \$122,395 for such services. The amounts due to the Company from TMGP are non-interest bearing and have no fixed terms of repayment.

#### **PROPOSED TRANSACTIONS**

None currently.

#### **RISKS AND UNCERTAINTIES**

The ability of the Company to become a viable provider of renewable and clean power is dependant upon a number of factors and includes, but is not limited to, the following: successful completion of hydrological studies to confirm that water flows are sufficient to generate enough electricity to provide a suitable return on investment, receipt of water licences, environmental and other permits to build and operate the projects, the successful negotiation of a long term contract with a purchaser of electricity, the ability to obtain sufficient equity and long term debt financing to construct the projects, support from First Nations that may have a claim to the land base where the Company's projects lie, community and stakeholder support and the ability to connect the projects to the BCTC grid, successful construction and operation of the generation facilities and associated transmission lines.

The Company is dependent upon the personal efforts and commitments of its existing management. To the extent that management's services would be unavailable for any reason, a disruption to the operations of Company could result.

The Company may need to raise additional equity and/or seek project equity financing to finance the equity portion for the construction of its projects. Existing shareholders of the Company may be subject to dilution.

## CRITICAL ACCOUNTING ESTIMATES

The Company's accounting policies are described in detail in Note 2 of the annual consolidated financial statements for the year ended December 31, 2007. The Company considers the following policies to be most critical in understanding its financial results:

### Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets, and commitments at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from these estimates due to factors such as changes in economic conditions, regulatory matters and negotiations with other parties.

### Carrying value of power development costs

The Company capitalizes direct costs associated with development of its power projects. Costs associated with successful projects are reclassified as capital assets and amortized over the useful life of the projects. The Company evaluates its power projects regularly for impairment and writes off costs that are not expected to be recoverable.

The recovery of power projects development costs is dependent upon the successful completion of the projects. The success of the power projects is dependent upon receiving the necessary water and other licences, the ability of the Company to obtain the necessary financing to successfully complete the development and construction of the projects, to generate sufficient electrical power and to sell the electricity generated on a profitable basis.

### Stock-based compensation

The Company uses the fair value method of accounting for options granted under its stock-based compensation plan. Stock options to employees are measured at the fair value of the consideration received or the fair value of the equity instruments issued whichever is more reliably measurable and are charged to operations over the vesting period. Stock options granted to consultants are valued at the time the options vest and at every reporting period for those not yet vested. The offset is credited to contributed surplus. Cash received on the exercise of stock options is recorded in share capital and the related compensation included in contributed surplus is transferred to share capital to recognize the total consideration for the shares issued.

The Company uses the Black-Scholes option pricing model to calculate the fair value of stock options and compensatory warrants granted. This model is subject to various assumptions. The assumptions the Company makes will likely change from time to time. At the time the fair value is determined, the methodology the Company uses is based on historical information, as well as anticipated future events.

## CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

Effective January 1, 2007, the Company adopted five new Canadian Institute of Chartered Accountants ("CICA") accounting standards: (a) Handbook Section 1530, *Comprehensive Income*; (b) Handbook Section 3855, *Financial Instruments - Recognition and Measurement*; (c) Handbook Section 3861 *Financial Instruments - Disclosure and Presentation*; (d) Handbook Section 3865, *Hedges*; and (e) Handbook Section 1506, *Accounting Changes*. The main requirements of these new standards and the resulting financial statement impact are described below.

### Comprehensive Income (Section 1530):

CICA Section 1530 introduces the term Comprehensive Income, which consists of net earnings and other comprehensive income ("OCI"). OCI represents changes in Unitholders' equity during the period arising from transactions and other events with non-owner sources. As a result of adopting this standard, a new Statement of Comprehensive Income now forms part of the Fund's consolidated financial statements which includes the current period net loss and OCI. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income, which is presented as a new category of Unitholders' Equity in the balance sheet.

Financial Instruments - Recognition and Measurement (Section 3855):

CICA Section 3855 sets out criteria for the recognition and measurement of financial instruments and requires all financial instruments within its scope, including derivatives, to be included on the balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized cost. Changes in fair value are to be recognized in either net earnings or OCI.

All financial assets and liabilities are recognized when the entity becomes a party to the contract creating the item. As such, any of the Fund's outstanding financial assets and liabilities at the effective date of adoption are recognized and measured in accordance with the new requirements as if these requirements had always been in effect. Any changes to the carrying values of assets and liabilities prior to January 1, 2007 are recognized by adjusting opening deficit or opening accumulated other comprehensive income.

As a result of the adoption of this standard, the Company's marketable securities have been classified as available for sale and as such at January 1, 2007 were revalued from their carrying cost of \$22,500 to their fair value of \$43,500, with the \$21,000 unrealized gain being recorded as a transition adjustment to the accumulated other comprehensive income. Subsequent to January 1, 2007, these financial instruments are revalued at each period end to fair market value.

Financial Instruments - Disclosure and Presentation (Section 3861):

CICA Section 3861 sets out standards which address the presentation of financial instruments and non-financial derivatives, and identifies the related information that should be disclosed. These standards also revise the requirements for entities to provide accounting policy disclosures, including disclosure of the criteria for designating as held-for-trading those financial assets or liabilities that are not required to be classified as held-for-trading; whether categories of normal purchases and sales of financial assets are accounted for at trade date or settlement date; the accounting policy for transaction costs on financial assets and financial liabilities classified as other than held-for-trading; and provide several new requirements for disclosure about fair value.

Hedging (Section 3865):

CICA Section 3865 specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed. The Company currently does not hold any financial instruments designated for hedge accounting.

Accounting Changes (Section 1506):

CICA Section 1506 revised the standards on changes in accounting policy, estimates or errors to require a change in accounting policy to be applied retrospectively (unless doing so is impracticable), changes in estimates to be recorded prospectively, and prior period errors to be corrected retrospectively. Voluntary changes in accounting policy are allowed only when they result in financial statements that provide reliable and more relevant information. In addition, these revised standards call for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. The impact of this new standard cannot be determined until such time as the Company makes a change in accounting policy, other than the changes resulting from the implementation of the new CICA Handbook standards previously discussed above.

Future changes in accounting standards:

On December 1, 2006, the CICA issued three new accounting standards applicable to the Company: Handbook Section 1535, *Capital Disclosures* ("Section 1535"), Handbook Section 3862, *Financial Instruments – Disclosures* ("Section 3862") and Handbook Section 3863, *Financial Instruments – Presentation* ("Section 3863"). These new standards become effective for the Company on January 1, 2008.

Section 1535 specifies the disclosure of: (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and, (iv) if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, revising its disclosure requirements, and carrying forward its presentation requirements. These new sections place

increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Company is currently evaluating the implications of the adoption of these new standards.

#### International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

#### **FINANCIAL AND OTHER INSTRUMENTS**

During 2007, TMGP entered into two interest rate swap contracts that on a combined basis cover the period from November 2007 to June 2045 on the draw down of \$100 million during the construction of Toba/Montrose project and the repayment of this debt during the operating term. Neither the Company nor TMGP have designated the interest rate swap contracts as hedges in accordance with CICA 3865, Hedges. As such, TMGP and the Company account for the interest rate swap contracts as derivative financial instruments and record the fair value of the two contracts on their balance sheets at each period end, with realized and unrealized gains or losses from the change in fair value recorded in the statement of operations. See note 11 in the consolidated financial statements of the Company for more information.

#### **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Any system of internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

#### **DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Company's management is responsible for establishing and maintaining disclosure controls and procedures to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), by others within those entities on a timely basis so that appropriate decisions can be made regarding public disclosure. THE CEO and CFO have evaluated the Company's disclosure controls and procedures and have concluded that they are effective as of December 31, 2007.

The Company's management is also responsible for designing internal controls over financial reporting, or causing it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. As of December 31, 2007, the CEO and CFO have designed, or caused to be designed under their supervision, such internal controls over financial reporting. Additionally, the CEO and CFO have identified no changes in the Company's internal control over financial reporting that occurred during the Company most recent interim period that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **CORPORATE ADDITIONS**

During 2007, the Company appointed the following officers:

Mr. Paul Sweeney to the position of Executive Vice-President, Corporate Development, Mr. Sweeney had been a financial consultant to the Company since March 2006. Mr. Sweeney has a strong track record of success with project finance, having most recently served as Chief Financial Officer of Canico Resource Corp. where he was responsible for among other things, arranging project financing for the Onca-Puma Nickel Project until Canico was acquired by CVRD. Prior to Canico, he was Vice-President and Chief Financial Officer for Sutton Resource Corp. where he had arranged the debt financing for the Bulyanhulu gold mine in Tanzania prior to its acquisition by Barrick Gold Corp.

Dr. Bruce Ripley, P. Eng., D. Eng. to the position of Executive Vice-President, Operations and subsequently to the position of President and Chief Operating Officer. Dr. Ripley has over 25 years of engineering experience in the hydroelectric industry including 16 years with BC Hydro where he was Vice-President, Engineering from 2004 through 2006. In this role, Dr. Ripley was responsible for delivery of engineering and construction projects for the generation, transmission and distribution systems with annual value of greater than \$400 million, and worked closely with planning, maintenance and operations programs. Dr. Ripley worked on projects in Canada, USA, China, Philippines and Australia. Dr. Ripley is a former President of the Tunnelling Association of Canada, has sat on the Boards of Powertech and Science World, and has been a member of the Electric Power Research Institute's Research Advisory Committee. Dr. Ripley has a Bachelor of Applied Science (Civil) from the University of British Columbia, and Master and Doctor of Engineering degrees (Civil) from the University of California.

Mr. Rupert A. Legge, to the position of Senior Vice President, Legal Affairs and Corporate Secretary, Mr. Legge joined the Company after more than 20 years practicing securities and corporate finance law with a major Vancouver law firm. While in practice, Mr. Legge advised numerous public companies at all stages of development on a wide variety of matters, including regulatory compliance and corporate governance. Mr. Legge holds a Bachelor of Business Administration degree from the University of Oregon and a Bachelor of Law degree from the University of British Columbia.

## **DISCLOSURE OF OUTSTANDING SHARE DATA**

As at March 10, 2008, the Company had the following common shares, stock options and warrants outstanding:

Common shares	41,921,968
Stock options (vested and unvested)	3,434,800
Warrants	2,718,235
Fully Diluted shares outstanding	48,075,003