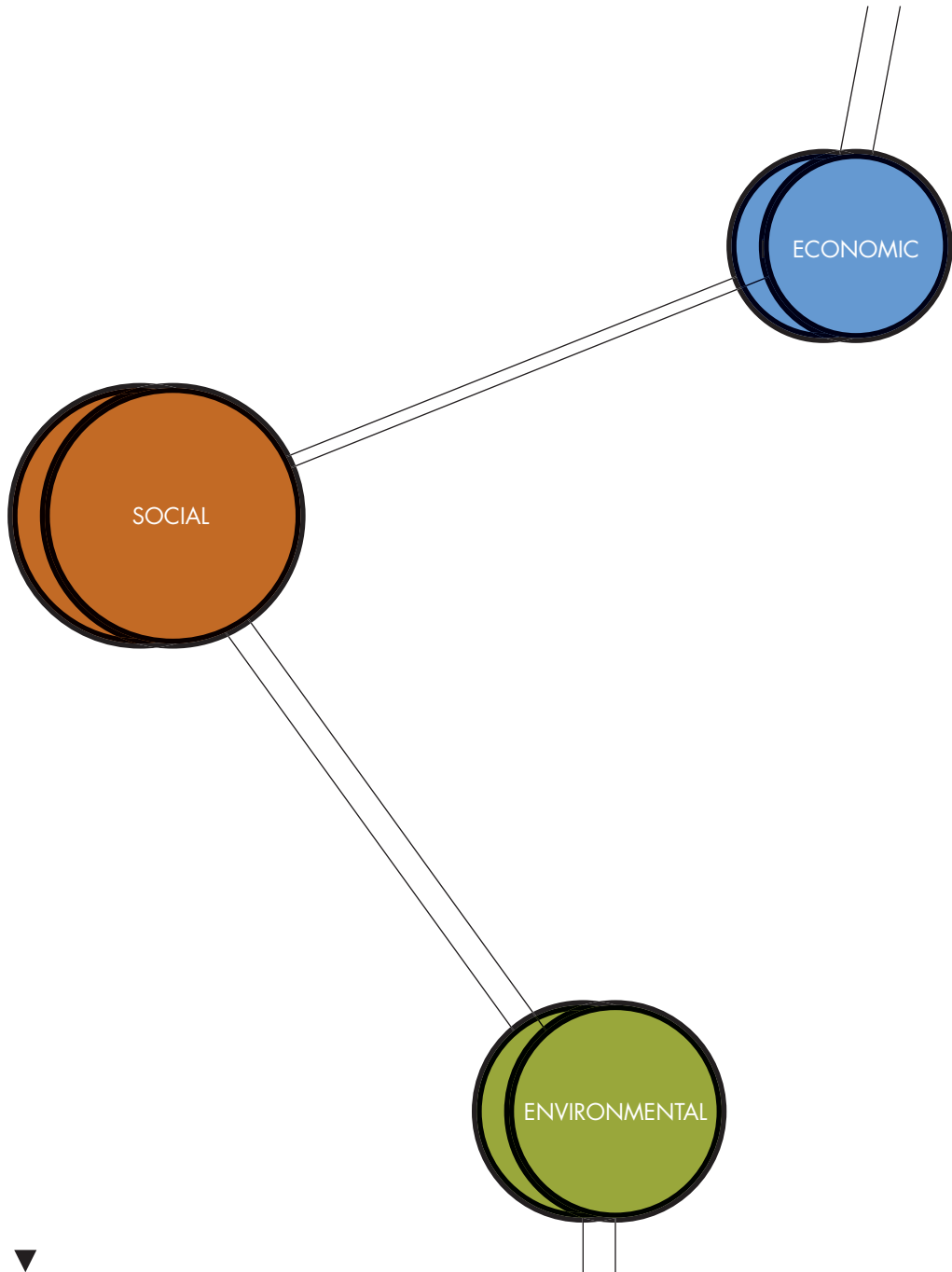


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# Overview

## KEY HIGHLIGHTS

### Financial

BC Hydro's net income for the second quarter showed a significant improvement at \$204 million compared to \$128 million in the same period last year. However, the income before regulatory account transfers was \$57 million compared to \$178 million in the same period last year.

For the six months ended September 30, 2006, BC Hydro's income before regulatory accounts was \$162 million, compared to \$136 million in fiscal 2006. Net income for the same period of \$204 million also shows a significant increase compared to net income of \$133 million for the same period last year. The current financial results for the year-to-date include the impact of a rate increase for domestic customers of 4.65% effective July 1, 2006, adjustments to the deferral account transfers to reflect a revised forecast for F2007 filed with the British Columbia Utilities Commission (BCUC) during the quarter, lower energy prices, operating costs and finance charges offset by higher amortization than the same period in fiscal 2006. The results do not include the impact of the recently approved negotiated settlement agreement related to the F07/F08 RRA (refer to note 8 of the consolidated financial statements).

This fiscal year, BC Hydro forecasts income before regulatory account transfers of approximately \$269 million. This \$115 million decrease from the first quarter forecast is mainly due to the impact of lower water inflows as a result of the drier than average summer. The forecast for net income for fiscal 2007, after taking the regulatory account transfers into consideration, is \$400 million, a \$5 million increase from that reported in the first quarter. Based on this forecast, BC Hydro's payment to the Province of B.C. for this fiscal year is expected to be \$322 million.

<i>(dollar amounts in millions)</i>	For the three months ended September 30			For the six months ended September 30		
	2006	2005	Change	2006	2005	Change
Income Before Regulatory Accounts	\$ 57	\$ 178	\$ (121)	\$ 162	\$ 136	\$ 26
Net Income	\$ 204	\$ 128	\$ 76	\$ 204	\$ 133	\$ 71
Accrued Payment to the Province	\$ 167	\$ 108	\$ 59	\$ 167	\$ 112	\$ 55
Number of Domestic Customers	n/a	n/a	n/a	1,721,322	1,689,326	31,996
GWh Sold (Domestic)	12,032	11,992	40	24,223	23,993	230
Total Reservoir Storage (GWh)	n/a	n/a	n/a	29,478	28,657	821

<i>(dollar amounts in millions)</i>	Sept 30 2006	March 31 2006	Change
Total Assets	\$ 12,947	\$ 12,704	\$ 243
Retained Earnings	\$ 1,744	\$ 1,707	\$ 37
Debt to Equity <sup>1</sup>	70:30	70:30	-

<sup>1</sup> Based on equity as defined for regulatory purposes

# Financial

## MANAGEMENT DISCUSSION AND ANALYSIS

The following section provides a discussion and analysis of BC Hydro's consolidated results and financial position. This section should be read in conjunction with the Management Discussion and Analysis presented in the 2006 Annual Report, 2006 Annual Consolidated Financial Statements of BC Hydro, and the interim consolidated financial statements of BC Hydro for the six months ended September 30, 2005 and 2006.

This report contains forward-looking statements, including statements regarding the business and anticipated financial performance of BC Hydro. These statements are subject to a number of risks and uncertainties that may cause actual results to differ materially from those contemplated in the forward-looking statements.

### **Consolidated Results of Operations**

BC Hydro's income before regulatory account transfers was \$57 million for the three months ended September 30, 2006 compared to \$178 million in the same period in fiscal 2006. The change was a result of a decrease in both domestic and trade gross margins and higher finance charges partially offset by lower operating costs and amortization.

The net income for the second quarter of \$204 million compared with \$128 million in the same period in the previous year. The change in net income is due to lower operating costs and amortization and a reduction in the amount of deferred trade income, offset by higher finance charges.

Income before regulatory account transfers of \$162 million for the six months ended September 30, 2006, compares with \$136 million for the same period in the previous year. The increase is due to an increase in the domestic gross margin, lower operating costs and finance charges, offset by lower trade gross margins and higher amortization.

BC Hydro's net income was \$204 million for the six months ended September 30, 2006, compared with \$133 million in the same six-month period in the previous year. The increase is primarily a result of lower operating costs and finance charges and a reduction in the amount of deferred trade income, offset by higher amortization expense and adjustments to the deferral account transfers to reflect a revised forecast for F2007 filed with the BCUC during the second quarter.

# Financial

## Revenues

For the three months ended September 30	in millions		gigawatt hours	
	2006	2005	2006	2005
Domestic:				
Residential	\$ 223	\$ 208	3,246	3,173
Light industrial and commercial	254	243	4,420	4,429
Large industrial	137	147	3,992	4,116
Other energy sales	37	24	374	274
<b>Total Domestic</b>	<b>\$ 651</b>	<b>\$ 622</b>	<b>12,032</b>	<b>11,992</b>
Trade:				
Electricity	\$ 204	\$ 399	8,864	8,241
Gas	106	87	1,840	1,250
<b>Total Trade</b>	<b>\$ 310</b>	<b>\$ 486</b>	<b>10,704</b>	<b>9,491</b>
<b>Total</b>	<b>\$ 961</b>	<b>\$ 1,108</b>	<b>22,736</b>	<b>21,483</b>

For the six months ended September 30	in millions		gigawatt hours	
	2006	2005	2006	2005
Domestic:				
Residential	\$ 449	\$ 426	6,743	6,523
Light industrial and commercial	498	482	8,828	8,724
Large industrial	268	290	7,979	8,149
Other energy sales	55	57	673	597
<b>Total Domestic</b>	<b>\$1,270</b>	<b>\$ 1,255</b>	<b>24,223</b>	<b>23,993</b>
Trade:				
Electricity	\$ 458	\$ 609	19,830	16,517
Gas	222	156	4,046	2,423
<b>Total Trade</b>	<b>\$ 680</b>	<b>\$ 765</b>	<b>23,876</b>	<b>18,940</b>
<b>Total</b>	<b>\$1,950</b>	<b>\$ 2,020</b>	<b>48,099</b>	<b>42,933</b>

Total revenue during the second quarter of fiscal 2007 was \$961 million, a decrease of 13 per cent over the same period last year. Domestic revenues increased due to the introduction of new customer rates with effect from July 1, 2006. Increased domestic customer demand in the residential and light commercial and industrial sector was offset by a reduction in the large industrial sector. Trade revenues reduced resulting from the decrease in average commodity prices offset by an increase in volumes traded.

Total revenues of \$1,950 million for the six months ended September 30, 2006 were \$70 million lower than the same period in the previous year. The primary reasons for the decrease are a reduction in electricity trading revenues due to significantly reduced commodity prices offset by increased trade volumes and increased domestic revenues due to higher rates and volumes.

# Financial

## Domestic Revenues

The rates applied for in BC Hydro's F07/F08 RRA, which included a 4.65 per cent increase, are in effect starting July 1, 2006, and are considered interim until approved by the BCUC. Revenues for the period from April 1 through June 30, 2006 were reported at the previously approved lower rates and the revenue deficiency arising from rates being increased on July 1 rather than April 1, 2006 has been included in the Fiscal 2007 Revenue Deficiency regulatory asset (included in the net change in regulatory accounts line on the statement of operations).

Total domestic revenues of \$651 million for the second quarter were \$29 million or 5 per cent higher than for the same period in the previous year due to increased rates. Total sales volumes were comparable to the prior year with 8,732 customers added to the system. The continued decline in revenue levels in the large industrial sector resulted from lower consumption in the pulp and paper industry, as well as the introduction of stepped rate pricing. Total domestic revenues of \$1,270 million for the six months ended September 30, 2006 were \$15 million or 1 per cent higher than for the same period in the previous year. Total domestic sales volumes increased by 1 per cent as a result of 31,996 customers added to the system, an increase in average consumption in the residential and light industrial and commercial sectors and the interim rate increase. The decline in revenue levels in the large industrial sector resulted from lower volumes in the pulp and paper industry and the introduction of stepped rate pricing.

## Trade Revenues

BC Hydro's electricity system is interconnected with systems in Alberta and the western United States. Interconnection facilitates sales and purchases of electricity outside of British Columbia. Energy trade activities are carried out by Powerex, a wholly owned subsidiary of BC Hydro. Trade activities help BC Hydro balance its system by being able to import energy to meet domestic demand when there is a supply shortage in the system due to such factors as low water inflows. Exports are made only after ensuring domestic demand requirements can be met.

Total trade revenues for the second quarter were \$310 million, a decrease of 36 per cent compared to \$486 million in the prior year. Trade sales volumes of 10,704 GWh increased by 13 per cent from 9,491 GWh in the second quarter of the prior year both from electricity and gas trading activities. The volume of electricity traded during the quarter was 8,864 GWh compared to 8,241 GWh in the second quarter of fiscal 2006. However, average sales prices for electricity were 7 per cent lower at a gross price of \$78/MWh (Fiscal 2006 - \$84/MWh). The volume of gas sales increased to 1,840 GWh during the second quarter from 1,250 GWh in the prior year as a result of expanded trading activity in that commodity. However, the average sales price for gas was 17 per cent lower at a gross price of \$58/MWh (Fiscal 2006 - \$70/MWh).

Electricity market prices decreased in the second quarter of fiscal 2007 compared to the same period last year, as summer temperatures were relatively cooler and gas storage levels were higher than last year which, together with a lack of extreme weather events, exerted significant downward pressure on gas prices. Gas prices in the second quarter of fiscal 2006 had been driven upwards as a result of effects of the hurricanes in the Gulf of Mexico which interrupted gas supply.

Trade revenues for the six months ended September 30, 2006 were \$680 million compared to \$765 million in the same period last year. There was a 26 per cent increase in total gas and electricity sales volumes, however, this was offset by a 14 per cent decrease in average sales prices for both gas at \$55/MWh (F2006 - \$65/MWh) and electricity at \$62/MWh (F2006 - \$72/MWh) as discussed above.

# Financial

## Energy Costs

Energy costs are influenced primarily by the volume of energy consumed by customers, the mix of sources of supply and market prices of energy. The mix of sources of supply is influenced by variables such as the current and forecast market prices of energy, water inflows, reservoir levels, energy demand and environmental and social impacts.

Energy costs are made up of the following sources of supply:

	For the three months ended September 30					
	(in millions)		(gigawatt hours)		(\$ per MWh)	
	2006	2005 <sup>1</sup>	2006	2005 <sup>1</sup>	2006	2005 <sup>1</sup>
Hydro <sup>2</sup>	\$ 57	\$ 75	9,681	12,658	\$ 5.90	\$ 5.75
Purchases from Independent Power Producers and other long-term contracts	100	115	2,348	2,453	42.59	46.88
Other electricity purchases - Domestic (net)	68	(5)	1,330	100	51.13	(50.00)
Thermal	29	14	449	97	64.59	144.33
Transmission charges and other	12	17	22	23	–	–
<b>Total Domestic</b>	<b>\$266</b>	<b>\$216</b>	<b>13,830</b>	<b>15,331</b>	<b>\$19.23</b>	<b>\$14.09</b>
Other electricity purchases – Trade	\$ 86	\$174	8,815 <sup>3</sup>	6,607 <sup>3</sup>	\$61.69	\$73.50
Remarketed Gas	103	91	1,972	1,306	52.23	69.68
Transmission charges and other expenses	61	63	–	–	–	–
<b>Total Trade</b>	<b>\$250</b>	<b>\$328</b>	<b>10,787</b>	<b>7,913</b>	<b>\$65.52</b>	<b>\$80.83</b>
<b>Total Energy Costs</b>	<b>\$516</b>	<b>\$544</b>	<b>24,617</b>	<b>23,244</b>	<b>\$39.56<sup>4</sup></b>	<b>\$36.81<sup>4</sup></b>

	For the six months ended September 30					
	(in millions)		(gigawatt hours)		(\$ per MWh)	
	2006	2005 <sup>1</sup>	2006	2005 <sup>1</sup>	2006	2005 <sup>1</sup>
Hydro <sup>2</sup>	\$110	\$ 128	18,798	21,813	\$ 5.94	\$ 5.82
Purchases from Independent Power Producers and other long-term contracts	198	219	4,353	4,606	45.49	47.55
Other electricity purchases - Domestic (net)	132	113	3,592	2,352	36.75	48.04
Thermal	39	27	535	191	72.90	141.36
Transmission charges and other	30	37	47	47	–	–
<b>Total Domestic</b>	<b>\$509</b>	<b>\$ 524</b>	<b>27,325</b>	<b>29,009</b>	<b>\$18.63</b>	<b>\$18.06</b>
Other electricity purchases – Trade	\$146	\$ 258	19,663 <sup>3</sup>	14,803 <sup>3</sup>	\$47.47	\$58.89
Remarketed Gas	214	162	4,262	2,535	50.21	63.91
Transmission charges and other expenses	129	112	–	–	–	–
<b>Total Trade</b>	<b>\$489</b>	<b>\$ 532</b>	<b>23,925</b>	<b>17,338</b>	<b>\$53.35</b>	<b>66.09</b>
<b>Total Energy Costs</b>	<b>\$998</b>	<b>\$1,056</b>	<b>51,250</b>	<b>46,347</b>	<b>\$34.84<sup>4</sup></b>	<b>\$36.03<sup>4</sup></b>

1. Prior year has been restated to reflect split between domestic and trade activities.

2. Includes net storage exchange due to Non-Treaty Storage Agreement with Bonneville Power Administration, Kootenay Canal Plant Agreement with Fortis, BC and Keenleyside Entitlement Agreement with Columbia Power Corporation. Price per MWh excludes net storage exchange.

3. Trade cost of energy volumes do not equal trade revenue volumes due to the return of prior years' energy to Powerex. The difference is included in domestic cost of energy volumes.

4. Total cost per MWh includes other electricity purchases at gross cost.

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For the second quarter of fiscal 2007 total energy costs of \$516 million were \$28 million or 5 per cent lower than the second quarter last year. The decrease is the result of a decrease in average prices, offset by an increased volume of energy supplied at 24,617 GWh, 6 per cent more than the prior year due to increased trade activity.

For the six months ended September 30, 2006, total energy costs of \$998 million were \$58 million lower than the same period last year. Domestic energy costs were \$15 million lower compared with the same period last year. Trade energy costs decreased by \$43 million for the six month period ending September 30, 2006.

## Domestic Energy Costs

Domestic energy costs were \$50 million higher than the second quarter of fiscal 2006, an increase of 23 per cent. Domestic consumption was met by increased thermal and other energy purchases to offset lower hydro generation as a result of lower water inflows than last year.

Domestic energy costs were \$15 million lower than the six months ended September 30, 2006, a decrease of 3 per cent. The change is primarily a result of the lower average cost of energy from all sources except for hydro generation than fiscal 2006 and lower transmission charges. Domestic consumption was met by increased higher cost thermal and other energy purchases to offset lower hydro generation and energy from IPPs than last year as a result of lower water inflows.

## Trade Energy Costs

Trade energy costs during the second quarter of fiscal 2007 decreased by \$78 million, or 24 per cent, compared to the same period last year. This was a result of significantly lower average commodity prices partially offset by a greater volume of electricity and gas purchases. Electricity purchases, at 8,815 GWh, were 33 per cent higher than prior year level at 16 per cent lower average prices. The difference between the electricity trade sales volumes and electricity trade purchase volumes of 49 GWh is the result of Powerex purchasing energy back from BC Hydro in the current fiscal year that BC Hydro had purchased from Powerex in previous fiscal years. The volume of gas purchased for sale to third parties increased significantly from 1,306 GWh to 1,972 GWh for the current year and average gas prices were 25 per cent lower than last year's levels at \$52/MWh.

Trade energy costs during the six months ended September 30, 2006 decreased by \$43 million, or 8 per cent, compared to the same period last year. This was the result of significantly lower average commodity prices offset by increased volumes of electricity and gas purchases and higher transmission charges. Electricity purchases, at 19,663 GWh, were 33 per cent higher than prior year level at 19 per cent lower average prices. The difference between the electricity trade sales volumes and electricity trade purchase volumes of 167 GWh is the result of Powerex purchasing energy back from BC Hydro in the current fiscal year that BC Hydro had purchased from Powerex in previous fiscal years. The volume of gas purchased for sale to third parties increased significantly from 2,535 GWh to 4,262 GWh for the current year and average gas prices were 21 per cent lower than last year's levels at \$50/MWh.



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## **Water Inflows**

Water inflows into BC Hydro's reservoirs were 8 per cent lower during the six months ended September 30, 2006 and 16 per cent down for the quarter compared to the prior year. This resulted in a decrease in the volume of low-cost hydro generation, one factor influencing the level of electricity imports and cost of energy. The decision to import energy instead of utilizing hydro generation is based on many factors, such as the forecast market price of energy in future periods relative to the current period, current reservoir levels and future demand requirements. Operating constraints related to legal and regulatory obligations such as minimum reservoir levels and stream flow requirements also affect the decision to import energy.

With lower inflows, reservoirs have been managed such that the combined storage in BC Hydro reservoirs at September 30, 2006, was 108 per cent of average compared with 106 per cent of average at September 30, 2005 (average storage levels relate to the average from 1986 to 2006), with the Williston Reservoir on the Peace River system at 105 per cent of average (Fiscal 2006 – 112 per cent) and the Kinbasket Reservoir on the Columbia River system at 113 per cent of average (Fiscal 2006 – 94 per cent).

## **Operating Costs**

Operations costs of \$58 million in the second quarter are \$35 million lower than in the same period last year. Operations costs for the six months ended September 30, 2006 are \$113 million, or \$41 million lower than in the same period last year. Decreases in both periods are attributed to reduced demand-side management incentives for large industrial customers as a result of new stepped rates.

Maintenance costs of \$68 million in the second quarter are \$2 million higher than in the same period last year. Maintenance costs for the six months ended September 30, 2006 of \$133 million are \$4 million higher than in the same period in the prior year. These results are mainly due to increased costs for generator rewedging and mountain pine beetle vegetation expenses than the prior year.

Administration costs of \$23 million for the second quarter and \$57 million for the six months ended September 30, 2006 are comparable to the same period last year.

## **Amortization Expense**

Amortization expense of \$85 million for the second quarter was \$9 million lower than for the same period in the previous year. A Depreciation Study was completed during fiscal 2006 which resulted in changes to assets lives that reduced depreciation charges. This impact was partially offset by a higher level of assets in service, and higher dismantling costs incurred. Amortization expense of \$197 million for the six months ended September 30, 2006 was \$8 million higher than for the same period in the previous year for similar reasons as the quarter's results offset by a one-time adjustment to reduce net book values by \$24 million, for which a regulatory asset has been established.

## **Finance Charges**

Finance charges of \$116 million for the three months ended September 30, 2006, were \$42 million higher than for the same period in the previous year. Higher short-term interest rates and a higher average volume of debt in the current year contributed to the higher charges. In addition, the prior period benefited from the impact of a strengthening Canadian dollar on unhedged U.S. dollar denominated debt. During fiscal 2006, BC Hydro hedged \$962 million of its U.S. dollar denominated debt which reduced the exposure to foreign exchange risk in the current quarter compared to the prior year and the benefit was not repeated.

Finance charges of \$215 million for the six months ended September 30, 2006, were \$11 million lower than for the same period in the

# Financial

previous year. The decrease in finance charges is primarily due to the elimination of significant translation losses on unhedged U.S. dollar denominated debt which has now been hedged. This was partially offset by higher short-term interest rates, lower sinking fund income and a lower average volume of debt.

## **Accounting Policies**

There were no accounting policy changes during the second quarter of fiscal 2007.

## **Regulation**

### ***Regulatory Accounts***

BC Hydro has established various regulatory accounts with approval of the BCUC. Regulatory accounts allow BC Hydro to defer certain types of revenue and cost variances through transfers to and from the accounts which have the effect of adjusting net income. The deferral amounts are then included in rates of future periods, subject to approval by the BCUC.

In the F07/F08 RRA, filed with the BCUC in May 2006, BC Hydro requested approval of three new regulatory accounts – Large Hydro Investigation costs, Fiscal 2007 Revenue Deficiency and Depreciation Study adjustments. It also requested that the cost of energy deferral accounts be modified to include the cost of load variance, net of incremental revenues. BC Hydro has received interim approval from BCUC for the establishment of the Fiscal 2007 Revenue Deficiency Account and is waiting for approval for the others. BC Hydro has prepared its accounts for the quarter under the assumption that approval for the other regulatory accounts will be received.

During the three months ended September 30, 2006, BC Hydro transferred \$147 million, on a net basis, from regulatory accounts compared to \$18 million transferred from regulatory deferral accounts in fiscal 2006. Effective July 1, 2006, adjustments were made to the deferral account transfers to reflect a revised forecast for fiscal 2007 file with the BCUC during the quarter.

During the six months ended September 30, 2006, BC Hydro transferred \$42 million, on a net basis, from regulatory accounts, compared with \$3 million transferred to regulatory deferral accounts in fiscal 2006. The net balance in the regulatory asset and liability accounts as at September 30, 2006, was \$465 million compared to \$178 million at September 30, 2005.

On November 6, 2006, a Negotiated Settlement Agreement (NSA) was filed with the BCUC with respect to the F07/F08 RRA. On November 10, 2006, the BCUC approved the NSA and the approved terms will be reflected in operating results commencing in the third quarter of fiscal 2007. Details of the financial terms of the NSA are included in note 8 of the consolidated financial statements.

# Financial

## Powerex Legal Proceedings

Since 2000, Powerex has been named, in some cases along with other energy providers, as a defendant in a number of lawsuits and U.S. federal regulatory proceedings which seek damages and/or contract rescission based on allegations that, during part of 2000 and 2001, the California wholesale electricity markets were unlawfully manipulated and that the energy prices were not just and reasonable. These proceedings are in various stages. A number of issues and findings are presently on appeal and none have been the subject of final judicial action. In the U.S. Court of Appeals for the Ninth Circuit's Lockyer decision of July 31, 2006, it told the U.S. Federal Energy Regulatory Commission (FERC) that it should reconsider its remedial powers thereby opening up the possibility that refunds will have to be paid for the periods from May to October 2000. On August 2, 2006, the Ninth Circuit ruled on certain issues in the FERC refund proceedings. One of those related to whether refunds should be paid for bilateral sales (those that did not go through the California Independent System Operator (CISO). In its decision, the Ninth Circuit upheld FERC's decision that refunds should not be paid for bilateral sales. The precise effect of these decisions on Powerex cannot be determined at this time.

At September 30, 2006, Powerex was owed US\$ 268 million (CDN\$ 299 million) by the markets operated by the California Power Exchange (Cal Px) and the California Independent System Operator (Cal ISO) related to Powerex's electricity trade activities in California during fiscal 2001. As a result of payment defaults by a number of California utilities, the Cal Px and Cal ISO were unable to pay these amounts to Powerex. That receivable will be offset against any refunds that Powerex is requested to pay.

On March 26, 2004, FERC approved a settlement agreement between FERC staff and Powerex that acknowledged that there was no evidence that Powerex engaged in any gaming practices or concerted partnership practices with any other market participants, and further noted that Powerex was a valuable and reliable supplier of energy and ancillary services to the California market throughout the energy crisis. This settlement is still subject to rehearing at FERC and FERC's final order may subsequently be appealed to the courts.

BC Hydro was also joined as a defendant in the California Consumer Class Action lawsuit through cross-claims by other defendants. In response to an application by BC Hydro to be dismissed from the lawsuit, a US Federal District Court judge ruled that BC Hydro is immune from these claims in the United States by virtue of the Foreign Sovereign Immunities Act. The Ninth Circuit upheld this finding. The court also upheld the District Court's finding that Powerex does not enjoy foreign sovereign entity status and therefore remains a party to the lawsuit, which was ordered to be remanded back to California State Court. Powerex is seeking appeal of the latter decision and related Ninth Circuit rulings to the US Supreme Court.

Due to the ongoing nature and uncertain status of the regulatory and legal proceedings related to the California power markets, management cannot predict at this time the outcome of the claims against Powerex and BC Hydro. BC Hydro has recorded provisions for uncollectible amounts and legal costs associated with the ongoing legal and regulatory impacts of the California energy crisis during fiscal 2001. These provisions are based on management's best estimates, and are intended to adequately provide for any exposure. However, the amounts that may ultimately be collected may differ from management's current estimates. Management has not disclosed the provision amounts or ranges of expected outcomes due to the potentially adverse effect on the collection process.

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## Liquidity and Capital Resources

Cash flow provided by operating activities for the second quarter was \$75 million, compared with \$138 million for the same period last year. The decrease was primarily due to an increase in finance charges and changes in working capital.

The net long-term debt balance at September 30, 2006, was \$6,884 million, compared with \$6,650 million at March 31, 2006. The increase was primarily due to an increase in Canadian debt due to a bond issue of \$300 million and an increase in revolving borrowings of \$28 million. The increase was partially offset by a decrease of \$90 million of U.S. debt due to the strengthening of the Canadian dollar vis-à-vis the U.S. dollar.

### **Property, Plant and Equipment Expenditures**

Property, plant and equipment expenditures were as follows:

(in millions)	For the three months ended September 30		For the six months ended September 30	
	2006	2005	2006	2005
Distribution improvements and expansion	\$ 77	\$ 65	\$ 144	\$ 123
Transmission lines and substation replacements & expansion	61	33	107	64
Generation replacements and expansion	42	29	72	49
General, including computers and vehicles	12	18	27	28
Change in working capital related to property, plant and equipment expenditures <sup>1</sup>	4	2	(7)	3
Property, plant and equipment expenditures per Consolidated Statement of Cash Flows	\$ 196	\$ 147	\$ 343	\$ 267

<sup>1</sup> Adjustment from accrual to cash expenditures on the Consolidated Statement of Cash Flows.

The increase in distribution improvements and expansion for the three month period ended September 30, 2006 is due to a higher volume of new customer construction and connections. The increase in transmission activity is primarily due to work on substation distribution assets. The increase in generation asset expenditures is due to the commencement of several new projects during the quarter including Coquitlam Dam Seismic Upgrade, the Peace Canyon Turbine Overhaul, Spillway Gate Program and the Fire Risk Program.

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## Risk Management

BC Hydro faces risks specific to its business that could significantly impact its ability to achieve its short- and long-term financial, social and environmental goals. The goal of risk management is not to eliminate risks, but rather to mitigate them to acceptable levels which are commensurate with potential benefits to be derived. While risks cannot be eliminated, BC Hydro's strategies aim to minimize or mitigate them with a specific risk management process that is applied to day-to-day business activities as well as to specific projects and initiatives. BC Hydro's Chief Risk Officer is responsible for overseeing the identification and assessment of risk management activities and ensuring strong oversight of significant risks by the Risk Management Committee. BC Hydro's Board of Directors also plays a key role in the risk management process, as the board must understand the risks being taken by BC Hydro and ensure these are appropriately managed.

During the first quarter of fiscal 2007, commodity risk continued to be elevated, driven by continued high levels of volatility and pricing in North American natural gas and western North American electricity markets as a result of the spring hydro inflows followed by the onset of the summer cooling season. While BC Hydro's reservoir storage provides some degree of flexibility to manage this risk in the short term, the current market environment continues to increase uncertainty around the cost of energy BC Hydro imports to meet domestic demand. This situation has been accentuated by the increasing gap between the domestic demand for energy resulting from the strong economic environment in British Columbia and BC Hydro's capacity to generate energy. BC Hydro is exposed to changes in interest rates. During the second quarter interest rates were relatively stable. Management's assessment of risk is ongoing. Other risks to BC Hydro have not changed materially from the Management Discussion and Analysis in the 2006 Annual Report.

During the first quarter fiscal 2007 BC Hydro had several filings under review with the BCUC including the F07/08 RRA, the 2006 Integrated Electricity Plan, the Long-Term Acquisition Plan and the associated fiscal 2006 Open Call for Power. BC Hydro has prepared its financial information for the quarter with the assumption that these various filings will be approved as submitted. One of these filings, the F07/F08 RRA, was approved on November 10, 2006. There are no assurances that approval will be received for the remaining filings, although management has no reason to believe at this time that there will be any material changes to the filings.

## Future Outlook

The *Budget Transparency and Accountability Act* requires that BC Hydro file a Service Plan each February. BC Hydro's Service Plan filed in February 2006 indicated that income before regulatory accounts for this year was forecast at \$7 million (restated for changes in regulatory disclosure pursuant to Accounting Guideline 19) and net income forecast at \$50 million. BC Hydro prepared an updated second quarter forecast in October 2006 that forecasts income before regulatory accounts of \$269 million and net income of \$400 million for fiscal 2007.

BC Hydro's earnings before regulatory transfers can fluctuate significantly due to various non-controllable factors such as the level of water inflows, customer load, market prices for electricity and natural gas, weather temperatures, interest rates and foreign exchange rates. The second quarter October forecast update assumes water inflows of 87 percent of average, customer load of 53,056 GWh, average market energy prices of US\$50/MWh, a consistent level of operating costs, short-term interest rates of 4.52 per cent and a U.S. dollar exchange rate of US\$0.8896.

The increase in forecast income from the Service Plan is from a combination of the customer rate increase applied for in May 2006, lower domestic energy costs due largely to lower market prices for purchased power, offset by increased operating costs, lower amortization expenses and lower finance costs.

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## CONSOLIDATED STATEMENT OF OPERATIONS

<i>(Unaudited)</i>	For the three months ended September 30		For the six months ended September 30	
<i>(in millions)</i>	<b>2006</b>	2005	<b>2006</b>	2005
<b>Revenues</b>				
Domestic	\$ 651	\$ 622	\$ 1,270	\$ 1,255
Trade	310	486	680	765
	961	1,108	1,950	2,020
<b>Expenses</b>				
Energy costs:				
Domestic	266	216	509	525
Trade	250	328	489	531
Operations	58	93	113	154
Maintenance	68	66	133	129
Administration	23	23	57	58
Taxes	38	36	75	72
Amortization	85	94	197	189
	788	856	1,573	1,658
<b>Operating Income</b>	173	252	377	362
Finance charges	116	74	215	226
<b>Income Before Regulatory Accounts</b>	57	178	162	136
<b>Net change in regulatory accounts (note 4)</b>	147	(50)	42	(3)
<b>Net Income</b>	\$ 204	\$ 128	\$ 204	\$ 133

See accompanying notes to the interim consolidated financial statements.

## CONSOLIDATED STATEMENT OF RETAINED EARNINGS

<i>(Unaudited)</i>	For the six months ended September 30	
<i>(in millions)</i>	<b>2006</b>	2005
Retained earnings, beginning of period	\$ 1,707	1,688
Removal of British Columbia Transmission Corporation from consolidated accounts (note 7)	-	(24)
Net income	204	133
Accrued Payment to the Province	(167)	(112)
Retained earnings, end of period	\$ 1,744	\$ 1,685

See accompanying notes to the interim consolidated financial statements.

# Financial

## CONSOLIDATED BALANCE SHEET

<i>(Unaudited)</i> <i>(in millions)</i>	as at September 30 <b>2006</b>	as at March 31 <b>2006</b>
<b>ASSETS</b>		
<b>Property, Plant and Equipment, net</b>	9,760	9,608
<b>Intangible assets</b>	410	413
<b>Current Assets</b>		
Cash and cash equivalents	13	23
Accounts receivable and accrued revenue	394	446
Materials and supplies	140	135
Prepaid expenses	148	93
Mark-to-market gains	307	277
	1,002	974
<b>Other Assets and Deferred Charges</b>		
Sinking funds	851	846
Regulatory assets (note 4)	924	863
	1,775	1,709
	\$ 12,947	\$ 12,704
<b>LIABILITIES AND EQUITY</b>		
Long-term debt net of sinking funds	\$ 5,344	\$ 5,696
Sinking funds presented as assets	851	846
<b>Long-Term Debt</b>	6,195	6,542
<b>Current Liabilities</b>		
Current portion of long-term debt	1,540	954
Accounts payable and accrued liabilities	908	1,089
Mark-to-market losses	300	301
	2,748	2,344
<b>Other Liabilities</b>		
Regulatory liabilities (note 4)	459	440
Deferred contributions	892	856
Debt issue and related costs	147	125
Other long-term liabilities	541	538
Foreign currency contracts	221	152
	2,260	2,111
<b>Retained Earnings</b>	1,744	1,707
	\$ 12,947	\$ 12,704

### **Commitments and Contingencies** (note 6)

See accompanying notes to the interim consolidated financial statements.

Approved on behalf of the Board:

L.I. (Larry) Bell  
*Chair*

W.C. (Wanda) Costuros  
*Chair, Audit and Risk Management Committee*

# Financial

## CONSOLIDATED STATEMENT OF CASHFLOWS

<i>(Unaudited)</i>	For the three months ended September 30		For the six months ended September 30	
<i>(in millions)</i>	<b>2006</b>	2005	<b>2006</b>	2005
<b>Operating Activities</b>				
Net income	\$ 204	\$ 128	\$ 204	\$ 133
Regulatory account transfers	(191)	42	(98)	(15)
Adjustments for non-cash items:				
Amortization of regulatory accounts	45	8	56	18
Amortization expense	85	94	197	189
Foreign exchange translation (gains) losses	-	(19)	(7)	17
Deferred revenue	-	-	-	(3)
Amortization of debt issue and related costs	(3)	(2)	(5)	(4)
Unrealized (gains) losses on mark-to-market	9	4	(31)	24
Sinking fund income	(10)	(16)	(19)	(33)
Employee benefit plan expenses	7	7	14	13
Other non-cash items	6	4	8	7
	152	250	319	346
Working capital changes	(77)	(112)	(155)	(94)
Cash provided by operating activities	75	138	164	252
<b>Investing Activities</b>				
Property, plant and equipment expenditures	(196)	(147)	(343)	(267)
Intangible asset expenditures	(4)	(5)	(6)	(8)
Deferred contributions	21	19	50	36
Dismantling costs	(4)	(3)	(7)	(7)
Cash used for investing activities	(183)	(136)	(306)	(246)
<b>Financing Activities</b>				
Bonds:				
Issued	300	400	300	400
Retired	-	(313)	-	(516)
Revolving borrowings	(217)	(372)	28	164
Sinking fund withdrawals	-	35	-	194
Deferred debt costs	27	90	27	90
Payment to the Province	-	-	(223)	(338)
Cash provided by financing activities	110	(160)	132	(6)
Increase (decrease) in cash and cash equivalents	2	(158)	(10)	-
Cash and cash equivalents, beginning of period	11	175	23	17
<b>Cash and cash equivalents, end of period</b>	<b>13</b>	<b>\$ 17</b>	<b>\$ 13</b>	<b>\$ 17</b>
<b>Supplemental disclosure of cash flow information</b>				
Interest paid	\$ 122	\$ 120	\$ 255	\$ 253

See accompanying notes to the interim consolidated financial statements



# Financial

## NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) SEPTEMBER 30, 2006

### **Purpose**

British Columbia Hydro and Power Authority (BC Hydro), was established in 1962 as a Crown corporation of the Province of British Columbia (the Province) by enactment of the Hydro and Power Authority Act. As directed by the Hydro and Power Authority Act, BC Hydro's mandate is to generate, manufacture, distribute and supply power. BC Hydro's corporate purpose is to provide "Reliable power, at low cost, for generations." BC Hydro is subject to regulation (see note 4) by the British Columbia Utilities Commission (BCUC) which, among other things, approves the rates BC Hydro charges for its services.

BC Hydro owns and operates electric generation and distribution facilities in the Province. BC Hydro also owns transmission facilities in the Province that are operated by British Columbia Transmission Corporation (BCTC), an independent Crown corporation of the Province.

### **Note 1: Accounting Policies**

The interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) for preparation of interim financial statements and do not conform in all respects to the disclosure requirements for annual financial statements. BC Hydro follows certain accounting practices that reflect the effects of regulation, and differ from the accounting practices for enterprises that do not operate in a rate-regulated environment. These interim consolidated financial statements and the notes (except for note 2 below) should be read in conjunction with the Annual Consolidated Financial Statements and accompanying notes in BC Hydro's 2006 Annual Report.

These interim consolidated financial statements follow the same accounting policies as those described in BC Hydro's 2006 Annual Report.

Certain figures for the previous period have been reclassified to conform to presentation in the current period.

### **Note 2: Change in Accounting Estimates**

As a result of a depreciation study that was conducted on property, plant and equipment, the estimated useful lives of various assets were changed. The changes in estimates were effective April 1, 2006 and have been accounted for prospectively. These changes in accounting estimates did not have a material impact on the net income during the period. The impact in subsequent periods is indeterminable and will depend on the level of future capital expenditures and asset disposals. The revised depreciation rates are subject to approval by the BCUC as part of the F07/F08 RRA.

### **Note 3: Seasonality of Operating Results**

Due to the seasonal nature of BC Hydro's operations, the interim consolidated statement of operations is not indicative of operations on an annual basis. Seasonal impacts of weather, including its impact on water inflows, energy consumption within the region and market prices of energy, can have a significant impact on BC Hydro's operating results.

# Financial

## NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) SEPTEMBER 30, 2006

### **Note 4: Regulation**

BC Hydro is regulated by the BCUC, and both entities are subject to general or special directives and directions issued by the Province. BC Hydro operates primarily under a cost of service regulation as prescribed by the BCUC. Orders in Council from the Province establish the basis for determining BC Hydro's equity for regulatory purposes, as well as its allowed return on equity and the annual payment to the Province. Calculation of its revenue requirements and rates charged to customers are established through applications filed with and approved by the BCUC.

BC Hydro applies various accounting policies that differ from GAAP for enterprises that do not operate in a rate-regulated environment. Generally, these policies result in deferral and amortization of costs and recoveries to allow for adjustment of future rates. In the absence of rate-regulation, these amounts would otherwise be included in the determination of net income in the year the amounts are incurred. These accounting policies support BC Hydro's regulation and have been established through ongoing application by approval of the BCUC.

In the F07/F08 RRA, filed with the BCUC in May 2006, BC Hydro requested approval of three new regulatory accounts – Large Hydro Investigation costs, Fiscal 2007 Revenue Deficiency and Depreciation Study adjustments. It also requested that the cost of energy deferral accounts be modified to include the cost of load variance, net of incremental revenues. BC Hydro has received approval from BCUC for the establishment of the Fiscal 2007 Revenue Deficiency Account and is waiting for approval of the others. BC Hydro has prepared its accounts for the quarter under the assumption that approval will be received (see Note 8).

For the above requested changes to the above mentioned regulatory accounts, the expected approval and likelihood of recovery or settlement of related amounts, is affected by risks and uncertainties relating to the ultimate decision of the BCUC and operating results experienced during the year.

# Financial

## NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) JUNE 30, 2006

### Regulatory Accounts

The following regulatory assets and liabilities have been established through rate regulation or have been applied for. For the six months ended September 30, 2006, the impact of regulatory accounting has resulted in an increase to net income of \$42 million (2006 – a decrease to net income of \$3 million).

<i>(in millions)</i>	April 1, <b>2006</b>	Additions	Amortn./ Other	Net change	Sept 30, <b>2006</b>	Sept 30, 2005
<b>Regulatory Assets</b>						
Heritage Deferral Account (HDA)	\$241	\$ 30	\$ (30)	\$ -	\$241	\$149
Non-Heritage Deferral Account (NHDA)	205	49	(25)	24	229	64
BCTC Transition Account	25	1	(1)	-	25	13
Demand-Side Management Programs	269	16	(17)	(1)	268	242
Foreign Exchange Gains and Losses	2	(7)	(8)	(15)	(13)	-
Large Hydro Investigation Costs	-	2	-	2	2	-
Depreciation Study Adjustments	-	24	(6)	18	18	-
Fiscal 2007 Revenue Deficiency	-	29	-	29	29	-
Deferred Debt Costs	-	-	-	-	-	9
Dam Safety and Site Survey Investigation Costs	-	-	-	-	-	51
First Nation Negotiations, Litigation and Settlement Costs	121	6	(2)	4	125	52
<b>Total Regulatory Assets</b>	<b>\$863</b>	<b>\$ 150</b>	<b>\$ (89)</b>	<b>\$ 61</b>	<b>\$924</b>	<b>\$580</b>
<b>Regulatory Liabilities</b>						
Regulatory Provision for Future Removal and Site Restoration Costs	\$226	\$ -	\$ (7)	\$ (7)	\$219	\$231
Trade Income Deferral Account (TIDA)	214	52	(26)	26	240	114
Unitized Bond Fund Account	-	-	-	-	-	57
<b>Total Regulatory Liabilities</b>	<b>\$440</b>	<b>\$ 52</b>	<b>\$ (33)</b>	<b>\$ 19</b>	<b>\$ 459</b>	<b>\$402</b>
<b>Net</b>	<b>\$423</b>	<b>\$ 98</b>	<b>\$ (56)</b>	<b>\$ 42</b>	<b>\$ 465</b>	<b>\$178</b>

# Financial

## NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) SEPTEMBER 30, 2006

### **Note 5: Employee Future Benefits**

BC Hydro's cost for employee future benefits for the second quarter ended September 30, 2006 was \$17 million (2005 – \$17 million). The cost for employee future benefits for the six months ended September 30, 2006 was \$34 million (2005 - \$34 million).

### **Note 6: Commitments and Contingencies**

#### ***Powerex***

Since 2000, Powerex has been named, in some cases along with other energy providers, as a defendant in a number of lawsuits and U.S. federal regulatory proceedings which seek damages and/or contract rescission based on allegations that, during part of 2000 and 2001, the California wholesale electricity markets were unlawfully manipulated and that the energy prices were not just and reasonable. These proceedings are in various stages. A number of issues and findings are presently on appeal and none have been the subject of final judicial action. In the U.S. Court of Appeals for the Ninth Circuit's Lockyer decision of July 31, 2006, it told the U.S. Federal Energy Regulatory Commission (FERC) that it should reconsider its remedial powers thereby opening up the possibility that refunds will have to be paid for the periods from May to October 2000. On August 2, 2006, the Ninth Circuit ruled on certain issues in the FERC refund proceedings. One of those related to whether refunds should be paid for bilateral sales (those that did not go through the California Independent System Operator (CISO)). In its decision, the Ninth Circuit upheld FERC's decision that refunds should not be paid for bilateral sales. The precise effect of these decisions on Powerex cannot be determined at this time.

At September 30, 2006, Powerex was owed US\$ 268 million (CDN\$ 299 million) by the markets operated by the California Power Exchange (Cal Px) and the California Independent System Operator (Cal ISO) related to Powerex's electricity trade activities in California during fiscal 2001. As a result of payment defaults by a number of California utilities, the Cal Px and Cal ISO were unable to pay these amounts to Powerex. That receivable will be offset against any refunds that Powerex is requested to pay.

On March 26, 2004, FERC approved a settlement agreement between FERC staff and Powerex that acknowledged that there was no evidence that Powerex engaged in any gaming practices or concerted partnership practices with any other market participants, and further noted that Powerex was a valuable and reliable supplier of energy and ancillary services to the California market throughout the energy crisis. This settlement is still subject to rehearing at FERC and FERC's final order may subsequently be appealed to the courts.

BC Hydro was also joined as a defendant in the California Consumer Class Action lawsuit through cross-claims by other defendants. In response to an application by BC Hydro to be dismissed from the lawsuit, a US Federal District Court judge ruled that BC Hydro is immune from these claims in the United States by virtue of the Foreign Sovereign Immunities Act. The Ninth Circuit upheld this finding. The court also upheld the District Court's finding that Powerex does not enjoy foreign sovereign entity status and therefore remains a party to the lawsuit, which was ordered to be remanded back to California State Court. Powerex is seeking appeal of the latter decision and related Ninth Circuit rulings to the US Supreme Court.

# Financial

## NOTES TO THE FINANCIAL STATEMENTS (UNAUDITED) SEPTEMBER 30, 2006

Due to the ongoing nature and uncertain status of the regulatory and legal proceedings related to the California power markets, management cannot predict at this time the outcome of the claims against Powerex and BC Hydro. BC Hydro has recorded provisions for uncollectible amounts and legal costs associated with the ongoing legal and regulatory impacts of the California energy crisis during fiscal 2001. These provisions are based on management's best estimates, and are intended to adequately provide for any exposure. However, the amounts that may ultimately be collected may differ from management's current estimates. Management has not disclosed the provision amounts or ranges of expected outcomes due to the potentially adverse effect on the collection process.

### **Electricity Purchase Agreements**

#### ***Energy Commitments – 2006 Call for Power***

Under the fiscal 2006 Open Call for Power, BC Hydro awarded 38 Electricity Purchase Agreements (EPAs) to producers throughout the province. As a result of a parallel tender process, BC Hydro also awarded a contract to the Brilliant Expansion Power Corporation, an affiliate of the Columbia Power Corporation. Once developed, these projects will add approximately 1,500 MW of capacity and over 7,000 GWh of energy per year (4,200 GWh of firm energy net of attrition and outages) to BC Hydro's integrated system. Allowing for an estimated attrition and outage factor of 30 per cent, BC Hydro's obligations in the years 2009 to 2051 have a total nominal value of approximately \$16,000 million.

### **Note 7: British Columbia Transmission Corporation**

The consolidated financial statements of BC Hydro include the accounts of BCTC for the year ended March 31, 2005. BC Hydro removed BCTC from its consolidated accounts effective April 1, 2005 when BCTC was considered operationally and financially independent of BC Hydro.

### **Note 8: Subsequent Event**

#### **Long term Energy Purchase Contract**

On November 1, 2006, BC Hydro entered into a long-term energy purchase contract with Alcan Inc. As part of the arrangement, an upfront fee of \$45 million is payable within 30 days of commencement of purchases under the contract. For revenue requirements purposes, the payment will be deferred and amortized over the life of the contract, which has a term of approximately 18 years.

The contract is subject to acceptance by the BCUC before finalization. Once approved, energy purchases are expected to commence on January 1, 2007.

# Financial

## **Status of F07/F08 Revenue Requirements Application (RRA)**

On November 6, 2006, a NSA was filed with the BCUC with respect to the F07/F08 RRA. On November 10, 2006, the BCUC approved the NSA.

The key terms of the NSA are as follows:

- BC Hydro received an interim rate increase of 4.65 per cent effective July 1, 2006. The BCUC approved final rate increases are 1.54 per cent (for July 1, 2006 to January 31, 2007) and 3.64 per cent (effective February 1, 2007 onward). Customers will see a 1 per cent decrease in their rates on February 1, 2007 and will receive a refund in early 2007 to adjust for higher interim rates that were in place for most of fiscal 2007.
- Included in the 3.64 per cent rate increase is a rate rider of 2 per cent for the purpose of recovering a portion of the current balances in the HDA, NHDA, TIDA and BCTC Transition deferral accounts. Recovery is estimated to be \$50.0 million in fiscal 2007 and \$55.8 million in fiscal 2008.
- The Fiscal 2007 Revenue Deficiency deferral account will be reduced to zero.
- The Large Hydro Investigation costs regulatory account was approved.
- Amounts related to variance in load from forecast will not be deferred.
- The amortization expense for contributions in aid incurred prior to 1996 will continue to be amortized over 25 years, not 45 years as recommended in the depreciation study and applied for in the RRA. The remainder of the depreciation study recommendations were approved.
- The adjustment to net book value of \$24 million resulting from the depreciation study will be amortized into income over 5 years as opposed to the requested period of 2 years.
- Reduction in the forecast finance charges, depreciation expense and operating costs in both fiscal 2007 and 2008.

The impact of the approved terms of the NSA will be reflected in operating results commencing in the third quarter of fiscal 2007. If the approved terms were incorporated into the year to date results, net income would decrease by \$48 million. The NSA is not expected to impact the forecast net income for the year.