

# Growth + Stability

ATLANTIC POWER CORPORATION ANNUAL REPORT 2005



AtlanticPower  
Corporation

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## Corporate Profile

Atlantic Power Corporation owns interests in a diversified portfolio of fifteen power generation projects located primarily in major markets in the United States. The Company's objectives are to sustain and grow its cash distributions over the long term by enhancing the performance of its existing assets and by making accretive acquisitions. The Company's Income Participating Securities (IPSs) are listed on the Toronto Stock Exchange under the symbol ATP.UN.



## Operating Highlights

- Completed accretive acquisition of 40% interest in Chambers project
- Sold Masspower asset and contracts for significant contribution to cash flow
- Increased ownership at Gregory project
- Executed accretive new Power Purchase Agreements at two existing projects
- Enhanced operating performance and cash flow at existing facilities
- Increased annual cash distributions to Cdn. \$1.03 per IPS

## Financial Highlights

(U.S. \$000 except where noted and per IPS data)

**12 Months Ended  
December 31, 2005**

Project revenue	184,700
Project income	48,256
Total assets	926,630
Cash flow available for distribution, Cdn. \$	58,981
Cash flow available for distribution per IPS, Cdn. \$	\$1.46
Total IPS distributions, Cdn. \$	39,124
Total distribution per IPS, Cdn. \$	\$1.01



Report To Shareholders: We were pleased with our performance in our first full year as a publicly-traded income fund. Most importantly, we achieved our goals of generating solid growth in cash flow and providing shareholders with our first increase in monthly cash distributions.

#### **A SUCCESSFUL YEAR**

2005 was a successful year for Atlantic Power on a number of fronts. We strengthened and further diversified our portfolio of power generating projects and grew distributable cash flow. In addition, with the completion of an accretive and strategic acquisition, we increased annualized cash distributions by \$0.03 per Unit while still maintaining a very conservative payout ratio of 67% for the year.

#### **CHAMBERS ACQUISITION**

In September we purchased a 40% interest in a 262 MW coal-fired cogeneration facility located at DuPont's Chambers Works complex in southwestern New Jersey. The plant has demonstrated an excellent operating history over the last ten years and is managed by a highly experienced operator. It utilizes the best available environmental control technologies, including scrubbers, a bag house, and selective catalytic reduction to reduce emissions. We were very pleased to have added this high quality and environmentally responsible power plant to our growing portfolio.

More importantly, the Chambers acquisition was immediately accretive to our cash flow, and provides a number of additional benefits to our shareholders. By adding two new investment grade electricity and steam off-takers, we strengthened our customer base and further mitigated risk for our shareholders. We also enhanced the diversity of our fuel sources, and increased the weighted average term of our power purchase agreement portfolio.

#### **COMPLETION OF MASSPOWER SALE**

During the year we sold our 17.5% indirect interest in the Masspower project, a 240 MW natural gas-fired power

plant located near Springfield, Massachusetts. As disclosed in our Initial Public Offering, the project's three largest Power Purchase Agreements (PPAs) terminated in March 2005, and since then it has largely been operating as a merchant facility. In total, we received over \$59 million in payments for the termination of the PPAs and the sale of other contracts and the physical asset. These proceeds exceeded the net present value of future cash flows projected at the time of our IPO by over \$20 million. The proceeds were then redeployed towards the accretive Chambers acquisition.

#### **NEW POWER PURCHASE AGREEMENTS**

Another important development during 2005 was the execution of new PPAs at our Gregory and Rumford plants. At the Rumford cogeneration facility in Maine, the prior PPA with Central Maine Power expired as expected on December 31, 2005. Under the interim one year PPA the Project will sell all of its power output to an adjacent paper manufacturing company at spot market prices. Whereas at the IPO we had anticipated no distributions from Rumford for 2006 and beyond, we now expect approximately \$4–6 million this year and are working with the project's partners to lock in profits over a longer term as indicated by NYMEX forward curves and anticipated fuel costs.

At the Gregory facility where a previous PPA expired as expected in June last year, with assistance from our management team a better credit quality counterparty was found, Constellation Energy, for a new agreement through 2008. This new PPA provides improved economics compared to projections at the IPO. These innovative transactions are excellent examples of how we are managing our PPA expirations and adding incremental cash flow by leveraging our



solid asset base and significant experience in the industry for the benefit of our investors.

In addition to these key transactions, we generated improved operating margins at a number of our facilities, and increased our ownership at the Gregory project, initiatives that contributed to our strong performance through the year.

#### **PRIVATE PLACEMENT – NEW INVESTOR**

We were also pleased during the year to welcome the Caisse de dépôt et placement du Québec as a major new investor in Atlantic Power. The proceeds from their \$75 million investment were used to redeem a portion of the ownership

**We are uniquely positioned in the U.S. market to grow our business over the next several years.**

interests held indirectly by our sponsor ArcLight Capital Partners pursuant to their stated objective to reduce their interest over time. ArcLight currently retains a 30% interest in Atlantic Power, and we continue to benefit from their considerable industry experience and extensive relationships within the North American power and energy business.

#### **ENHANCING PROJECT PERFORMANCE**

With these transactions, our portfolio currently consists of 15 power producing projects primarily located in nine states representing most of the major U.S. power markets. In aggregate, Atlantic's interest in the generating capacity of our projects totals 802 MW. In addition, our capacity remains well diversified based on electricity and steam off-takers, regulatory jurisdictions, and regional power pools, mitigating our exposure to market, regulatory and environmental conditions specific to any one region. Our plants sell their electricity and steam to 23 different off-takers, with over 95% of the contracted generation sold to investment-grade off takers.

During the year numerous initiatives were completed to enhance cash flow from our existing plants. One example is a

gas turbine upgrade at our Orlando facility that improved both its efficiency and output. Like all similar maintenance capital expenditures at the plants, this project was accomplished with operating funds before partnership distributions to Atlantic, and generally all such capex is expensed unless it contributes to a more significant expansion of output.

#### **DELIVERING ON OUR GROWTH STRATEGIES**

We will evaluate additional acquisition opportunities within the fragmented North American independent power industry that meet our acquisition and investment guidelines and result in an increase in cash available for our investors. The immediate contribution to cash flow derived from the purchase of our interest in the Chambers project is an excellent example of how we are creating value by adding new projects to our growing portfolio.

We will also work with our project operators and managers to enhance the operating and financial performance of our facilities through ongoing operational improvements and the optimization of our power purchase agreements, fuel supply contracts and other commercial arrangements. We experienced enhanced performance at a number of our projects in 2005, and the new PPAs at our Rumford and Gregory facilities will contribute to our growth going forward.

Finally, we will continue to consolidate and increase our ownership in projects where we have partial interests. The contribution to cash flow from our increased interest in the Gregory project during 2005 is a case in point of how this strategy is enhancing the value of our portfolio.

Looking ahead, our ultimate objective remains to deliver predictable, stable and growing cash distributions for our investors. We made considerable progress in 2005, and we believe we have the facilities, the industry relationships and the management expertise to build on the strong track record of performance demonstrated by our projects over the past year.

In closing, I would like to thank our customers, partners and sponsors for their significant contributions over the past year, and our shareholders for their continued support.



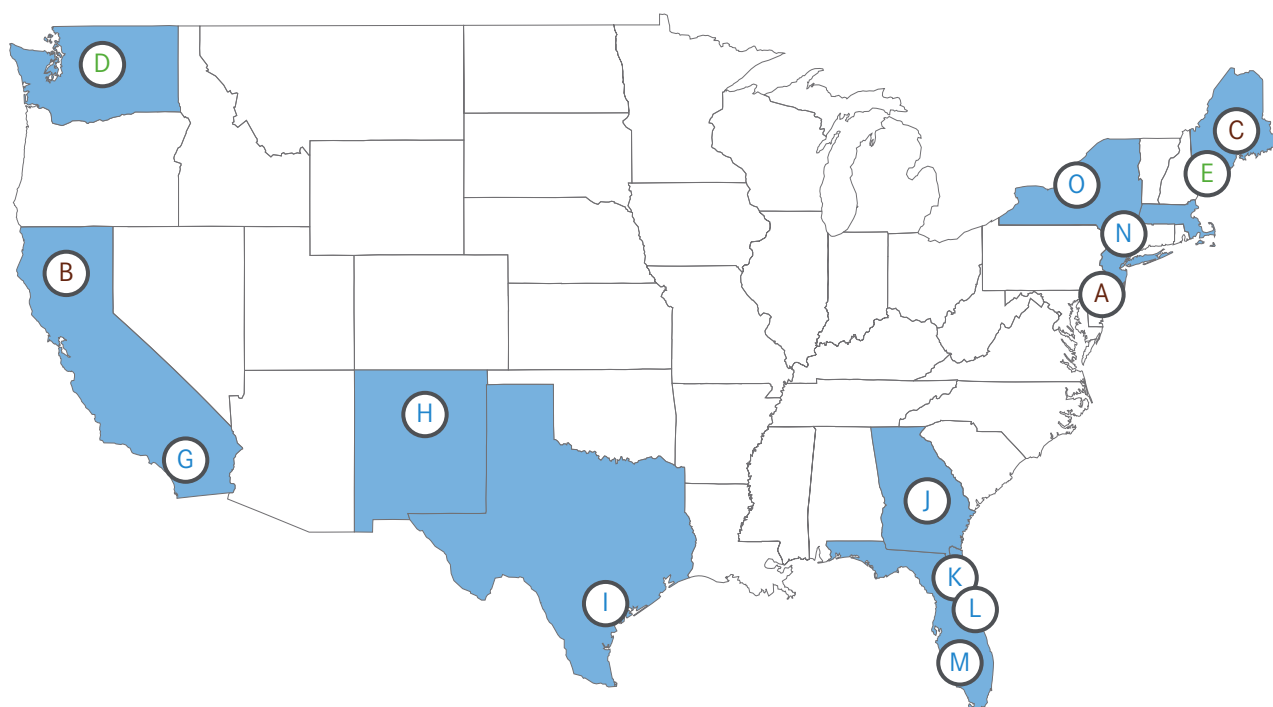
**BARRY WELCH**  
*President and CEO*





# At a Glance... Proven Value Enhancing Strategies

1//Accretive acquisitions from third parties; 2// Enhance performance of existing projects;  
3//Consolidate ownership in current Projects.



## Coal

- A // **Chambers**, Carney's Point, NJ
- B // **Stockton**, Stockton, CA
- C // **Rumford**, Rumford, ME

## Hydro

- D // **Koma Kulshan**, Whatcom County, WA
- E // **Topsham**, Topsham, ME

## Fuel Oil

- F // **JPPC**, Kingston, Jamaica

## Gas

- G // **Badger Creek**, Bakersfield, CA
- H // **Delta-Person**, Albuquerque, NM
- I // **Gregory**, Corpus Christi, TX
- J // **Mid-Georgia**, Kathleen, GA
- K // **Lake**, Umatilla, FL
- L // **Orlando**, Orlando, FL
- M // **Pasco**, Tampa, FL
- N // **Selkirk**, Bethlehem, NY
- O // **Onondaga**, Geddes, NY





## PROJECT PORTFOLIO

Project Name	Location (State)	Fuel Type	Total MW	Ownership Interest <sup>1</sup>	Acct Tmt <sup>2</sup>	Net MW <sup>3</sup>	Electricity Off-Taker's	PPA Expiry	Off-Taker's S&P Credit Rating
Badger Creek	California	Natural Gas	46	50.00%	P	23	Pacific Gas & Electric	2011	BBB
Chambers (Carney's Point)	New Jersey	Coal	262	40.00%	P	74 16 15	Atlantic City Electric DuPont Merchant <sup>9</sup>	2024 2024 N/A	BBB+ AA- N/A
Delta-Person	New Mexico	Natural Gas	132	40.00% <sup>4</sup>	E	53	Public Service of New Mexico	2020	BBB
Gregory	Texas	Natural Gas	400	17.10%	E	59 9	Constellation Energy <sup>5</sup> Reynolds Metals	2008 2020	BBB NR
JPPC	Jamaica	Fuel Oil	60	24.10%	E	14	Jamaica Public Service	2018	B
Koma Kulshan	Washington	Hydro	13	49.80%	P	6	Puget Sound Energy	2037	BBB-
Lake	Florida	Natural Gas	110	100.00%	C	110	Progress Energy Florida	2013	BBB
Mid-Georgia	Georgia	Natural Gas	308	50.00%	P	154	Georgia Power	2028	A
Onondaga	New York	Natural Gas	91	100.00%	C	91	Niagara Mohawk	2008 <sup>6</sup>	A
Orlando	Florida	Natural Gas	126	50.00%	P	44 19	Progress Energy Florida Reedy Creek Improvement District	2023 2013	BBB A-
Pasco	Florida	Natural Gas	109	49.90%	P	54	Progress Energy Florida	2008	BBB
Rumford	Maine	Coal/Biomass	85	23.50% <sup>4</sup>	E	20	NewPage <sup>7</sup>	2006	NR
Selkirk	New York	Natural Gas	345	18.50% <sup>4</sup>	E	15 49	Niagara Mohawk Consolidated Edison	2008 2014	A A
Stockton	California	Coal	55	50.00%	P	24 3	Pacific Gas & Electric Corn Products Int'l	2008 2008	BBB BBB-
Topsham	Maine	Hydro	14	50.00% <sup>8</sup>	P	7	Central Maine Power	2011	BBB

1 Represents the percentage ownership interest in the Project held indirectly by Atlantic Holdings (except as otherwise noted).

2 Accounting Treatment: (refer to Note 1 of Consolidated Financial Statements).

C = Consolidated P = Proportionate Consolidation E = Equity Method

3 Represents the interest of Holdings in each Project's electric generation capacity based on Holdings' economic interest in each project.

4 Represents Holdings' estimate of its economic interest in the Project's cash flow.

5 New PPA with Constellation Energy through 2008. See discussion in the New Power Purchase Agreements Section of the MD&A.

6 A swap agreement with Niagara Mohawk Power Corporation has replaced the Onondaga PPA.

7 PPA with Central Maine Power expired December 31, 2005. See discussion of the new interim PPA with the former Mead/Westvaco paper mill (now owned by NewPage) in the New Power Purchase Agreements section of the MD&A.

8 Holdings owns a lessor interest in this Project.

9 The merchant output of the facility is sold by Atlantic City Electric in the PJM regional spot market through a profit sharing arrangement with Chambers.

# Management Discussion and Analysis of Financial Condition and Results of Operations

The following management discussion and analysis (“MD&A”) of financial condition and results of operations should be read in conjunction with the audited financial statements of Atlantic Power Corporation (“Atlantic Power” or the “Company”) for the year ended December 31, 2005. All amounts described in the management discussion and analysis of financial condition and results of operations are in thousands of U.S. dollars, unless otherwise stated. The financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). This management discussion and analysis of financial condition and results of operation also contains forward-looking statements, which are subject to a variety of factors. When used in this MD&A, the words “anticipate”, “expect”, “project”, “believe”, “estimate”, “forecast” and similar expressions are intended to identify forward-looking statements, which include statements relating to the projects. Such statements are subject to a variety of risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, weather, economic conditions and other factors that could cause actual results to differ materially from those contemplated by these statements. Some of the factors that could cause results or events to differ from current expectations include, but are not limited to, the factors described under “Risk Factors”. Information contained in this management discussion and analysis is based on information available to management as of March 31, 2006.

Copies of financial data and other publicly filed documents are available through the internet on SEDAR at [www.sedar.com](http://www.sedar.com) under Atlantic Power Corporation.

## OVERVIEW

The Company completed its Initial Public Offering (“IPO”) on November 18, 2004 and after the exercise of the underwriter’s over-allotment on December 6, 2004, it owned 58.1% of the common membership interests and all of the outstanding Class A preferred membership interests in Atlantic Power Holdings, LLC (“Holdings”). Holdings was formed initially to acquire indirect interests in a diversified portfolio of power generating facilities (the “Projects”) located primarily in major markets in the United States from ArcLight Energy Partners Funds I and II (the “ArcLight Funds”) and Caithness Energy (such entities, together, the “Existing Investors”). The Company currently has 44,339,500 Income Participating Securities (“IPSs”) outstanding and owns 70.1% of Holdings. Each IPS represents one common share of the Company (“Common Shares”) and Cdn. \$5.767 aggregate principal amount of 11% subordinated notes of the Company (“Subordinated Notes”).

As of December 31, 2005 Holdings owned interests in fourteen projects in the United States and one in Jamaica with a combined total power generating capacity of 2,156 megawatts (“MW”). Holdings’ interests in the projects represented approximately 860 MW of power generating capacity as of December 31, 2005. Most of the projects sell their power under long-term Power Purchase Agreements (“PPAs”) to investment grade utilities. These agreements are typically structured to stabilize cash flows by 1) providing a significant revenue component of steady capacity payments generally designed to provide a return of and on capital plus cover most fixed operating costs regardless of how much electricity the project is called upon to produce, provided that the plant meets an availability requirement and 2) passing through most of the Projects’ fuel costs to the utilities. As a result, effects on the portfolio’s cash flow changes in the amount of power generated, spot market electricity prices and fuel price changes are significantly mitigated.

The Company’s objectives are to maintain the stability and sustainability of cash distributions to holders of IPSs in the form of interest payments on Subordinated Notes and dividends on Common Shares, and to increase, when prudent, dividends on the Common Shares. To achieve these objectives, Company management, working directly with project managers, focuses on enhancing the operation of the existing projects by improving facility performance, increasing output, optimizing contracts and hedging cash flows when practicable. In addition, the Company has a focused growth strategy that includes the consolidation of interests in projects that it currently owns and making accretive acquisitions with a primary focus on power generating facilities in the United States.

## **SUMMARY OF SIGNIFICANT EVENTS**

On January 12, 2005, Holdings increased its indirect interest in the Gregory project from 9.4% to 17.1% or 68 net MW. The interest was acquired indirectly via Holding's interest in Javelin and was accomplished using cash available at the project level, discussed further in Acquisitions & Dispositions.

On September 8, 2005, Holdings acquired an indirect 40% interest in Chambers Cogeneration, LP, ("Chambers") which owns and operates a 262 MW coal-fired cogeneration plant in southwestern New Jersey, discussed further in Acquisitions & Dispositions. On the same day, the Company also announced a Cdn. \$0.03 increase in its annual distribution per IPS to Cdn. \$1.03 per year, commencing with the September distribution.

On October 3, 2005, the Company issued 7.5 million Income Participating Securities to Caisse de dépôt et placement du Québec ("the Caisse") at a price of Cdn. \$10.00 per IPS in a private placement. Net proceeds, along with proceeds from the issuance of 39,500 IPSs to certain officers of the Company, were used to increase the Company's common membership interest in Holdings to 70.1%. The remaining 29.9% of the common membership interests and all of the outstanding Class B preferred membership interests in Holdings are owned by the Existing Investors.

On December 28, 2005, Holdings sold its 17.5% interest in the 267 MW Masspower project following the restructuring of the project's PPAs and subsequent disposition of its gas supply and transportation contracts, which is discussed further in Acquisitions & Dispositions.

## **NON-GAAP FINANCIAL MEASURES**

Cash Flow Available for Distribution is not a measure recognized under GAAP and does not have a standardized meaning prescribed by GAAP. Management believes Cash Flow Available for Distribution is a relevant supplemental measure of the Company's ability to earn and distribute cash returns to investors. A reconciliation of net cash provided by operating activities from the Company's financial statements to Cash Flow Available for Distribution is set out in this MD&A. Investors are cautioned that the Company may calculate this measure in a manner that is different from other companies.

Earnings before interest, taxes, depreciation and amortization ("EBITDA") is not a measure recognized under GAAP and does not have a standardized meaning prescribed by GAAP. Management uses aggregate unaudited EBITDA at the Projects as a cash flow measure to provide aggregate annual comparative information about project performance. A reconciliation of 2005 Project EBITDA to Project Income is appended to this MD&A. Investors are cautioned that the Company may calculate this measure in a manner that is different from other companies.

## **RESULTS OF OPERATIONS FOR THE THREE AND TWELVE MONTH PERIODS ENDED DECEMBER 31, 2005**

The Company commenced operations on November 18, 2004 on completion of its IPO and the acquisition of interests in fifteen non-utility power projects. The Company did not hold any material assets prior to November 18, 2004 and is considered to have begun operations on that date. The financial results for the year ended December 31, 2005 include the contribution from the 40% interest in the Chambers project, acquired on September 8, 2005 and the sale of the Masspower project interest (see Acquisitions & Dispositions). Since the prior year period that ended on December 31, 2004 was only six weeks in length, no meaningful comparison of financial information is available. As of December 31, 2005, the Company had PPAs with 16 customers. Details on the length of the PPAs for each Project are presented in the table in the Project Portfolio section below.

Project Income is the primary determinant of the Company's operating results and is discussed in the Project Performance section below. Within Administrative and Other Expenses, the cash items are expected to be relatively steady, including management fees and administration, net interest (principally interest on Subordinated Notes and revolving credit facility) and the distribution to non-controlling interest (29.9% of Holdings owned by Existing Investors at December 31, 2005, 41.9% at December 31, 2004). Significant non-cash items subject to potentially significant fluctuations include the change in fair value of the non-controlling investors, which is based on the change in price of the Company's IPSs from period to period, and the non-cash portion of the foreign exchange gain or loss, reflecting the impact of foreign exchange changes from period to period on the value of the Company's Canadian dollar denominated debt and the mark-to-market value of currency hedges.

Net Income for the three months ended December 31, 2005 was negatively impacted by increased amortization resulting from the finalization of the purchase price allocation with respect to Projects acquired November 18, 2004 and positively impacted by the inclusion of Chambers for the full quarter.

#### **BREAKDOWN OF SUMMARY FINANCIAL INFORMATION**

Appendix I to this MD&A provides an unaudited non-GAAP breakdown of the 2005 summary Income Statement and Balance Sheet information into the categories of 1) Consolidated and proportionately consolidated, 2) Proportionate share of Equity Investments, and 3) Corporate.

#### **PROJECT PERFORMANCE: THREE MONTH PERIOD ENDED DECEMBER 31, 2005**

EBITDA at the Projects was up 24%, excluding the Masspower disposals and the deferred revenue adjustment at Mid-Georgia. Significant contributors to the increased EBITDA included 1) improved operating margins at the Lake, Orlando and Pasco projects, 2) increased ownership in the Gregory project combined with a new PPA, and 3) a full quarter of Chambers ownership. Offsetting the increase in part were expected lower scheduled swap settlements at Onondaga and the effect of fuel cost pass-through limitations at Selkirk as is more fully discussed in the following section.

While aggregate generation was up by 15%, plant availability declined by 3.9% at the projects during the fourth quarter of 2005 compared to the fourth quarter of 2004. The comparative increase in generation in the fourth quarter of 2005 is due to a modest increase in dispatch at Selkirk, increased ownership at Gregory and a full quarter of Chambers offset in part by reduced generation resulting from a major planned outage at Gregory in 2004. Availability decreases are primarily driven by an extension of the 2005 planned outage at Orlando and both planned and forced outages at Gregory. Generation can be higher while plant availability is lower based on the degree to which the plants are called upon, or dispatched, to run during their available hours.

## Summary of Financial Results (In thousands of U.S. dollars)

	3 Months Ended December 31, 2005 (Unaudited)	12 Months Ended December 31, 2005 (Audited)
Project revenue <sup>1</sup>	58,023	184,700
Project expenses	46,312	144,193
Project other income (expense) <sup>2</sup>	(4,052)	7,749
<b>Project Income</b>	<b>7,659</b>	<b>48,256</b>
Administrative and other expenses		
Management fees and administration	1,693	5,095
Amortization of deferred financing costs	247	990
Interest, net	7,178	23,698
Distribution, non-controlling interest <sup>3</sup>	4,340	20,578
Gain on disposal of equity investment	-	(5,015)
Change in fair value of non-controlling interest <sup>4</sup>	(6,404)	(6,404)
Gain on settlement of non-controlling interest	(4,184)	(4,184)
Foreign exchange gain (loss) <sup>5</sup>	1,872	6,453
<b>Total administrative and other expenses</b>	<b>4,742</b>	<b>46,226</b>
Income (loss) before income taxes	2,917	2,030
Income taxes expense (recovery)	179	2,539
<b>Net income (loss)</b>	<b>2,738</b>	<b>(509)</b>
<i>Per IPS, USD</i>	0.06	(0.01)
<i>Per IPS, Cdn.</i>	0.07	(0.02)
Total assets	926,630	926,630
Long-term debt	224,482	224,482
Subordinated notes	251,844	251,844
Non-controlling interest	169,479	169,479
Index swap hedge	33,453	33,453
Other liabilities	39,827	39,827
Total long-term liabilities <sup>6</sup>	719,085	719,085
Cash flows from operating activities	19,473	38,730
Distributions <sup>6</sup>	9,760	32,448
<i>Per IPS, USD</i>	0.22	0.83
<i>Per IPS, Cdn.</i>	0.26	1.01

<sup>1</sup> Project revenue and project expenses of Holdings' interests in ten Projects, including two wholly owned Projects which are consolidated, and eight proportionately consolidated Projects with interests ranging from 40% to 50%. (Refer to Accounting Treatment presented in the table in the Project Portfolio section later.)

<sup>2</sup> Includes equity in earnings from partnerships of \$(7,928) for the three-month period and \$8,446 for the twelve-month period from five projects in which Holdings owns interests of between 17.1% and 40%, accounted for on an equity basis.

<sup>3</sup> Distributions declared to Existing Investors.

<sup>4</sup> As of December 31, 2004, Existing Investors owned a 41.9% non-controlling interest in Holdings with certain Liquidity Rights to request that the Company use best efforts to issue equity securities (including IPSs) to raise proceeds that would indirectly be used to redeem portions of the Existing Investors' interest. On October 3, 2005, the Existing Investors reduced their common membership interests in Holdings to 29.9%. Until November 18, 2006, the Existing Investors must maintain a minimum 10% aggregate ownership interest in Holdings. This amount represents the mark-to-market change during the reporting period in the potential obligation of the Company to issue securities to redeem the entire Existing Investors' interests in Holdings based on the change in market price per IPS from Cdn. \$10.75 at December 31, 2004 and September 30, 2005 to Cdn. \$10.40 at December 31, 2005.

<sup>5</sup> Net impact of foreign exchange on the U.S. dollar equivalent of Canadian dollar denominated debt, the mark-to-market value of currency hedges and realized foreign exchange gains and losses for the period.

<sup>6</sup> Distributions declared during the reporting period.

## **PROJECT PERFORMANCE: YEAR ENDED DECEMBER 31, 2005**

Aggregate generation was up 5% and availability was down 1% at the Projects during 2005 compared to the prior full year operating history of the Projects. EBITDA at the Projects was up 20% for the year, excluding the Masspower disposals and a deferred revenue adjustment at Mid-Georgia. Significant factors in this EBITDA increase include 1) favourable impacts from improved operating margins at the Lake, Orlando, and Pasco projects, 2) increased ownership in the Gregory project combined with a new PPA at that project that benefits from high gas costs and 3) almost four months of Chambers ownership, offset by unfavourable impacts from 1) fuel costs under recently renewed fuel supply agreements at Selkirk that increased during the period to slightly above the formulaic amount that can be passed through to the utility under one of its PPAs and 2) lower scheduled swap settlement payments received at Onondaga.

Among the Company's largest costs is the supply of natural gas, coal and other fuels. Fuel costs, particularly natural gas costs, were at historically high levels in the U.S. throughout the reporting period. However, the majority of the PPAs provide for the pass-through or indexing of fuel costs to the off-takers. Therefore, EBITDA has not been significantly impacted by the higher prices. Some projects, like Gregory, show margin improvements at higher gas prices. Selkirk extended the term of three of its four gas purchase agreements towards the end of 2004 and replaced the fourth contract effective November 1, 2005. While most of the gas cost is passed through in the power purchase price under the Project's PPA with Consolidated Edison, there is a formulaic cap in the energy payment that may be slightly exceeded at some times by the Project's fuel cost. During the year ended December 31, 2005 this cap was exceeded at times, resulting in slightly reduced margins at Selkirk.

## **CASH FLOW FROM OPERATIONS AND RESERVE ACCOUNT**

The Company's cash flow from the Projects will vary from year to year based on, among other things, changes in rates under the PPAs, fuel supply and transportation agreements, steam sales agreements and other project contracts, compliance with the terms of non-recourse project-level financing including debt repayment schedules, the transition to market pricing following the expiry of PPAs, fuel supply and transportation contracts, working capital requirements and the operating performance of the Projects. Project cash flows themselves may have some seasonality and the pattern and frequency of distributions from Projects to Holdings during the year can also vary.

The Company's cash flow from operations was \$19,473 and \$38,370 for the three-month period and year ended December 31, 2005, respectively, and was in line with expectations for the year. The annual results include significant cash flow of \$59,365 from the disposal of the Masspower PPAs, fuel supply agreements and the sale of the facility.

In order to provide holders of IPSs with stable and sustainable cash distributions, the Company established a Reserve Account at the closing of its IPO and will deposit funds in the Reserve Account from time to time to stabilize future cash distributions and fund acquisitions and other growth opportunities that have the same ultimate effect. The Reserve Account held \$12,509 as of December 31, 2004. It increased by \$35,857 in March based largely on the Masspower PPA termination payments and reached a maximum of \$48,737 in July before dropping by \$38,500 in August in connection with the Chambers acquisition. As of December 31, 2005, the Reserve Fund held \$10,508.

## **CASH FLOW AVAILABLE FOR DISTRIBUTION**

Holders of IPSs receive cash distributions in the form of interest payments on Subordinated Notes and dividends on Common Shares. On September 8, 2005, the Company announced an increase to its annual dividend of Cdn. \$0.03 per IPS commencing with the September distribution from Cdn. \$1.00 to Cdn. \$1.03 per IPS. For the three month period ended December 31, 2005, aggregate distributions of \$9.8 million were declared (Cdn. \$0.26 per IPS comprised of interest payments of Cdn. \$0.16 on the 11% subordinated note portion of the IPS, plus Cdn. \$0.10 common share dividend per IPS).

The table below presents the calculation of Cash Flow Available for Distribution beginning with cash flow from operating activities for the three month period and year ended December 31, 2005.



## Calculation of Cash Flow Available for Distribution (In thousands of U.S. dollars)

Periods Ended (Unaudited)	3 Months Ended December 31, 2005	12 Months Ended December 31, 2005
Cash flow available for distribution		
Cash flows from operating activities <sup>1</sup>	\$ 19,473	\$ 38,370
Project level debt repayment	(10,052)	(20,679)
Interest on IPS portion of subordinated notes	6,009	20,346
Income tax withholding installments recoverable <sup>2</sup>	768	7,682
Income tax payable on disposal of equity investment <sup>3</sup>	5,519	5,519
Addition to property, plant and equipment	(1,068)	(2,558)
Cash flow available for distribution, USD	20,649	48,680
<b>Cash flow available for distribution, Cdn.</b>	<b>24,013</b>	<b>58,981</b>
Distributions		
Interest on IPS subordinated notes	6,009	20,346
Dividend on IPS common shares	3,751	2,102
Total IPS distributions, USD	9,760	32,448
<b>Total IPS distributions, Cdn.</b>	<b>11,421</b>	<b>39,124</b>
<b>Cash flow available for distribution per IPS, Cdn.</b>	<b>0.54</b>	<b>1.46</b>
<b>Total distribution per IPS, Cdn.</b>	<b>0.26</b>	<b>1.01</b>

<sup>1</sup> In previous quarters, Masspower's distributions in respect of disposal proceeds were included in Cash flows from operating activities and separately netted out of Cash flow available for distribution. Those proceeds now appear as a disposal in the financing activities section of the statement of cash flows.

<sup>2</sup> Represents the portion of income tax withholding installments paid during the quarter related to operating activities which are anticipated to be recoverable by the Company.

<sup>3</sup> In the second and third quarters estimated tax payments of \$5,281 on Masspower disposals were not added back in the calculation of cash flow available for distribution. This fourth quarter calculation benefits from adding back the entire \$5,519 finalized estimate of tax payable on the Masspower disposal.

## SUMMARY OF QUARTERLY RESULTS

Variations in quarterly results are driven by the following factors:

- There is some seasonality of Project Revenues based on some projects being paid higher rates during peak seasons, which tends to be summer in the US markets.
- Variations in quarterly cash flow and distributions from Projects accounted for using the equity method are also driven by the timing of non-recourse debt payments at the Projects (i.e., some are made quarterly and some semi-annually), as distributions from the Projects to the Company must occur in conjunction with the Projects passing certain tests at those payment dates.
- Non-cash charges, principally 1) the change in fair value of the non-controlling investors, which is based on the change in price in the Company's IPSs from period to period, and 2) the non-cash portion (majority) of the foreign exchange gain or loss, reflecting the impact of foreign exchange changes from period to period on the value of the Company's Canadian dollar denominated debt and the mark-to-market value of currency hedges.
- Net Income for the three months ended December 31, 2005 was negatively impacted by increased amortization resulting from the finalization of the purchase price allocation with respect to projects acquired November 18, 2004.
- Cash flow from operations was higher in the first and fourth quarters of 2005 due to the proceeds from Masspower dispositions of three of its PPAs and the physical plant respectively.

- Calculation of cash flow available for distribution (“CFAD”) during the first three quarters included a reduction of cash flow from operating activities (“CFFO”) by the proceeds of Masspower disposals. The disposal proceeds are now presented in the financing activities section of the statement of cash flows, so reduction of the proceeds from CFFO is not required.
- During the fourth quarter, the Company finalized the estimated tax on Masspower disposals of \$5,519, which has been included in the above CFAD table as a separate line item. In the second and third quarters, estimated tax payments of \$5,281 on Masspower disposals were not added back in the calculation of CFAD. The fourth quarter CFAD calculation benefits from adding back the entire \$5,519 finalized estimate of tax payable on the Masspower disposal.

#### Selected Quarterly Consolidated Financial Data (unaudited)

	2005					2004
	Total	Q4	Q3	Q2	Q1	Nov. 18 - Dec. 31
Project Revenues	\$184,700	\$58,023	\$50,848	\$37,966	\$37,863	\$18,490
Net income (loss)	(509)	2,738	(7,863)	(5,326)	9,942	(19,894)
Cash flow from operating activities	38,370	19,473	6,242	8,098	4,557	12,897
Cash distributions (a)	32,448	9,760	7,808	7,385	7,495	3,658
Cash available for distribution (b)	48,680	20,649	9,130	11,551	7,350	5,119
Payout ratio (a divided by b)	67%	47%	86%	64%	102%	71%
Per IPS Statistics						
Net income (loss)	(\$0.01)	\$0.06	(\$0.21)	(\$0.14)	\$0.27	(\$0.57)
Cash flow from operating activities	0.87	0.44	0.17	0.22	0.12	0.37
Cash available for distribution, USD	1.23	0.47	0.25	0.31	0.20	0.14
<b>Cash flow available for distribution, Cdn.</b>	<b>1.46</b>	<b>0.54</b>	<b>0.30</b>	<b>0.38</b>	<b>0.24</b>	<b>0.17</b>
Distributions, USD	0.83	0.22	0.21	0.20	0.20	0.10
<b>Distributions, Cdn.</b>	<b>1.01</b>	<b>0.26</b>	<b>0.25</b>	<b>0.25</b>	<b>0.25</b>	<b>0.12</b>

#### ACQUISITIONS & DISPOSITIONS

CHAMBERS // On September 8, 2005, Holdings closed the acquisition of Epsilon Power Partners, LLC (“Epsilon”), which owns a 40% interest in Chambers Cogeneration LP (“Chambers”), the owner and operator of the 262 MW (net output) Carney’s Point pulverized coal-fired cogeneration facility located at E.I. DuPont de Nemours & Company’s (“DuPont”) Chambers Works complex in southwestern New Jersey. The purchase price was approximately \$105 million and was funded through Holdings’ cash on hand and a draw on Holdings’ revolving credit facility and the assumption of \$43 million of non-recourse Epsilon debt. The facility acquired is one of the projects in which Holdings was granted a right of first offer by ArcLight Energy Partners Fund I, L.P. at the time of Atlantic’s IPO. The former owners of Epsilon are subsidiaries of ArcLight Energy Fund I and Delta Power Company, LLC.

The project sells electricity through 2024 under a PPA with Atlantic City Electric Company (rated BBB+) and electricity and steam to DuPont (rated AA-) for use in its industrial operations, also through 2024. Carney’s Point began commercial operations in 1994.

Plant operations are managed by a highly experienced firm and the Project has demonstrated an excellent operating history over the last ten years. The facility utilizes the best available environmental control technologies including scrubbers, a baghouse and selective catalytic reduction to reduce emissions and is considered one of the cleanest coal-fired power plants in the U.S.

On November 8, 2005, the Company filed on SEDAR an Independent Technical Review for Chambers. The report, prepared by Stone & Webster Management Consultants, Inc., concludes that the Project uses proven and appropriate technology,

has operated successfully under the principal project agreements and permits since its commercial operation in 1994, has been well-maintained, and has an expected useful life exceeding the life of the PPA, which expires in 2024. The report also includes a cash flow projection for Chambers through 2024.

**MASSPOWER** // In March 2005, the Masspower project completed the restructuring and monetization of three of its four PPAs through a buyout of the contracts by Boston Edison and Commonwealth Electric. During the second and third quarters of the year, the project disposed of its long-term fuel supply and transportation agreements. On December 28, 2005, Atlantic, along with the other partners of the Masspower facility, sold its interest in the physical facility along with the remaining PPA. During 2005, the Company received distributions of \$61,469 generated from operations, PPA restructuring, fuel contract disposals and sale of the facility.

**GREGORY** // On January 12, 2005, Holdings increased its indirect interest in the Gregory project from 9.4% to 17.1% or 68 net MW. The interest was acquired indirectly via Holdings' interest in Javelin and was accomplished using cash available at Javelin (\$1,074 was Atlantic's portion).

#### **NEW PROJECT POWER PURCHASE AGREEMENTS**

On July 15, 2005, the Gregory Project's PPA with Dynegy expired as expected. Gregory is located in the ERCOT regional electricity market in Texas, which has been returning to supply-demand balance following a period of overbuilding new plants and, more recently, very substantial retirements of older utility plants. Effective September 1, 2005, Gregory entered into a PPA with Constellation Energy (S&P: BBB) that expires December 31, 2008. Consistent with information filed on SEDAR at the time of the IPO, Gregory is still not anticipated to be a significant contributor to near term cash flows, but under the new contract it is now expected to produce cumulative cash flows that are higher than management's previous expectations for the period September 1, 2005 through December 31, 2008.

Rumford's PPA with Central Maine Power expired as anticipated at the end of December 2005. While earlier projections at the time of the IPO showed no cash flow for 2006 and beyond from Rumford, the project has entered into an interim agreement to sell all of its output for 2006 to the NewPage paper mill at New England power market prices. This agreement is anticipated to produce distributions of approximately \$4,000 to \$6,000 in 2006 and management also believes that there is an opportunity to produce cash flow beyond 2006 by extending the PPA with the NewPage paper mill, selling the output into the New England power market, or entering into a contract with a power marketing entity.

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

The Company has adequate liquidity from several sources in addition to cash flow from operations. For 2005, the Company's payout ratio of total distributions to cash flow available for distribution was 66.7%. The Reserve Fund held \$10,508 as of December 31, 2005. In the future, as the Reserve Fund builds, a portion of it will be available to fund acquisitions and other growth opportunities, enhancing the long-term stability of distributions.

Holdings recently increased the capacity of its revolving credit facility from \$50,000 to \$75,000, \$15,061 of which was allocated, but not drawn as of December 31, 2005, to support letters of credit for contingent liabilities at several projects. On September 1, 2005, a draw of \$25,000 was made to partially fund the Chambers acquisition. After a paydown utilizing proceeds from the sale of Masspower in December 2005, the drawn amount was reduced to \$10,000. Approximately 50,000 is available to the Company under the facility as of December 31, 2005. In addition, the Projects themselves generally have their own reserve accounts to support payments for major maintenance costs and project-level debt service. For Projects that are consolidated or proportionately consolidated with Atlantic, these amounts or Atlantic's portion of these amounts respectively, are reflected as Restricted Cash on Atlantic's balance sheet, which was \$26,758 as of December 31, 2005.

All project-level debt and the Epsilon debt assumed in the Chambers acquisition is non-recourse to the Company or Holdings and is fully amortized over the life of the Projects' PPAs.

## CAPITAL EXPENDITURES

Capital expenditures for the Projects are made at the project level using project cash flows and project reserves. Therefore, the distributions that Holdings receives from the Projects are made net of capital expenditures needed at the projects. Generally, capital expenditures are not significant since most major expenditures are for repairs and maintenance and therefore are expensed.

During the third quarter, an estimated \$2,000 capital project was completed at the Pasco project to construct a water distillation facility that will serve as the project's thermal load. Total capital expenditures ("capex") for 2005 were \$2,558. Estimated capex for 2006 is not more than \$2,500.

## CONTRACTUAL OBLIGATIONS – DEBT

Contractual Obligations (In thousands of U.S. dollars)	Payment due by period				
	Total	2006	2007-9	2010-11	2012 and beyond
Long-term debt					
Subordinated Notes	<b>251,844</b>	-	-	-	251,844
Non-recourse project debt *	<b>246,040</b>	21,558	63,777	31,925	128,780
<b>Total Contractual Obligations</b>	<b>497,884</b>	<b>21,558</b>	<b>63,777</b>	<b>31,925</b>	<b>380,624</b>

\* Project debt is non-recourse to the Company and fully amortizing during PPA terms.

## PROJECT PORTFOLIO

The following table outlines the Company's portfolio of power generating assets as of December 31, 2005, including its interest in each facility. Management believes the portfolio is well diversified based on electricity and steam buyers, regulatory jurisdictions and regional power pools, thereby mitigating exposure to market, regulatory or environmental conditions specific to any one region.

## PROJECT PORTFOLIO

Project Name	Location (State)	Fuel Type	Total MW	Ownership Interest <sup>1</sup>	Acct Tmt <sup>2</sup>	Net MW <sup>3</sup>	Electricity Off-Taker's	PPA Expiry	Off-Taker's S&P Credit Rating
Badger Creek	California	Natural Gas	46	50.00%	P	23	Pacific Gas & Electric	2011	BBB
Chambers (Carney's Point)	New Jersey	Coal	262	40.00%	P	74 16 15	Atlantic City Electric DuPont Merchant <sup>9</sup>	2024 2024 N/A	BBB+ AA- N/A
Delta-Person	New Mexico	Natural Gas	132	40.00% <sup>4</sup>	E	53	Public Service of New Mexico	2020	BBB
Gregory	Texas	Natural Gas	400	17.10%	E	59 9	Constellation Energy <sup>5</sup> Reynolds Metals	2008 2020	BBB NR
JPPC	Jamaica	Fuel Oil	60	24.10%	E	14	Jamaica Public Service	2018	B
Koma Kulshan	Washington	Hydro	13	49.80%	P	6	Puget Sound Energy	2037	BBB-
Lake	Florida	Natural Gas	110	100.00%	C	110	Progress Energy Florida	2013	BBB
Mid-Georgia	Georgia	Natural Gas	308	50.00%	P	154	Georgia Power	2028	A
Onondaga	New York	Natural Gas	91	100.00%	C	91	Niagara Mohawk	2008 <sup>6</sup>	A
Orlando	Florida	Natural Gas	126	50.00%	P	44 19	Progress Energy Florida Reedy Creek Improvement District	2023 2013	BBB A-
Pasco	Florida	Natural Gas	109	49.90%	P	54	Progress Energy Florida	2008	BBB
Rumford	Maine	Coal/Biomass	85	23.50% <sup>4</sup>	E	20	NewPage <sup>7</sup>	2006	NR
Selkirk	New York	Natural Gas	345	18.50% <sup>4</sup>	E	15 49	Niagara Mohawk Consolidated Edison	2008 2014	A A
Stockton	California	Coal	55	50.00%	P	24 3	Pacific Gas & Electric Corn Products Int'l	2008 2008	BBB BBB-
Topsham	Maine	Hydro	14	50.00% <sup>8</sup>	P	7	Central Maine Power	2011	BBB

1 Represents the percentage ownership interest in the Project held indirectly by Atlantic Holdings (except as otherwise noted).

2 Accounting Treatment: (refer to Note 1 of Consolidated Financial Statements).

C = Consolidated P = Proportionate Consolidation E = Equity Method

3 Represents the interest of Holdings in each Project's electric generation capacity based on Holdings' economic interest in each project.

4 Represents Holdings' estimate of its economic interest in the Project's cash flow.

5 New PPA with Constellation Energy through 2008. See discussion in the New Power Purchase Agreements Section of the MD&A.

6 A swap agreement with Niagara Mohawk Power Corporation has replaced the Onondaga PPA.

7 PPA with Central Maine Power expired December 31, 2005. See discussion of the new interim PPA with the former Mead/Westvaco paper mill (now owned by NewPage) in the New Power Purchase Agreements section of the MD&A.

8 Holdings owns a lessor interest in this Project.

9 The merchant output of the facility is sold by Atlantic City Electric in the PJM regional spot market through a profit sharing arrangement with Chambers.

## **OTHER CONTRACTUAL OBLIGATIONS**

### **A // PROJECT CONTRACTS**

Each project typically has a set of contracts that include the following obligations of the project partnerships, all of which are non-recourse to the Company. Therefore, specific contracts for individual projects are not discussed in detail in the MD&A.

- PPAs generally allow projects to pass through their fuel costs. See the earlier project Portfolio table for off-takers and durations.
- Fuel supply agreements may have minimum volume requirements.
- Fuel transportation agreements incorporate capacity reservation/demand payments for natural gas, or shipping cost per ton of coal.
- Steam sales agreements track PPA lengths and are designed to meet regulatory requirements for thermal load/efficiency at fossil fuel plants.
- O & M agreements contract for operations and maintenance services by third parties or owners.
- Long-term service agreements may be in place for gas or steam turbine inspections and overhauls.
- Site lease agreements grant use of project land where Projects do not own the site.

A detailed description of the Projects' agreements at the time of the IPO is contained in the Technical Review performed by Stone & Webster in conjunction with the Company's IPO, updated information contained in the Company's Annual Information Form dated March 30, 2006 and a detailed review of contracts at the newly acquired Chambers project in Stone & Webster's review. All documents are available on SEDAR.

**B // FINANCIAL INSTRUMENT CONTRACTS** – see Financial and Other Instruments section below.

### **C // CREDIT FACILITY**

Holdings has a \$75,000 revolving credit facility, \$15,061 of which was allocated, but not drawn as of December 31, 2005, to support letters of credit for contingent liabilities at several projects. \$10,000 was drawn under the revolving term credit facility as of December 31, 2005.

### **D // OFFICE OPERATING LEASE OBLIGATIONS**

The Manager subleases its office space from ArcLight, under an agreement through 2014. The obligations under this sublease are \$130 per year in 2005-2007 and a total of \$933 for the period 2008-2014.

### **E // MANAGEMENT AND INCENTIVE FEES**

The Company pays a management fee under the Management Agreement that is subject to adjustment for acquisitions as agreed to by the Company and Holdings' Independent Managers, plus incentives, inflation adjustment and expenses. The Company paid the Manager \$2,990 in management and incentive fees during the year ended December 31, 2005.

### **F // SUBORDINATED NOTES**

As of December 31, 2005, the Company had \$251,844 outstanding of 11% subordinated notes due 2016. The notes pay interest only until their maturity.

## RELATED PARTY TRANSACTIONS

The Manager has been engaged under the Management Agreement to provide certain management and administrative services to the Company and Holdings, for which it is paid (1) an annual management fee, (2) reimbursement of costs, and (3) an incentive fee equal to 25% of the excess in distributions paid to IPS holders and Existing Investors during the year above Cdn. \$1.00 per IPS. The Management Agreement has an initial term of 20 years from the Company's November 2004 IPO. The Manager is owned by ArcLight Funds. Subsidiaries of the ArcLight Funds along with a subsidiary of Caithness Energy owned 41.9% of Holdings' common membership interests after the IPO, but reduced their interest to 29.9% in October 2005 in connection with the sale of 7,539,500 IPSs to the Caisse and certain officers of the Company, as discussed earlier.

The seven-person Board of Managers of Holdings includes two members from the manager of the ArcLight Funds who were appointed by the Existing Investors, and the President/CEO of the Manager. These three individuals may not vote on any proposed acquisitions by Holdings of projects from the ArcLight Funds.

The Manager receives administrative and office support services from the manager of the ArcLight Funds under a Management Support Agreement. This agreement also requires ArcLight and its affiliates to give the Manager the opportunity to pursue, on behalf of the Company and Atlantic Holdings, investment opportunities that do not fit within the investment guidelines for ArcLight Fund I and Fund II or other investment funds managed by ArcLight or its affiliates.

At the time of the IPO, Holdings was granted a right of first offer ("ROFO") on a number of power producing projects owned by the ArcLight Energy Partners Fund. The right of first offer related to interests in 11 power generating projects representing approximately 706 net MW of total electric generation capacity. During the third quarter of 2005 Holdings completed the acquisition of Chambers, one of the ROFO projects, as described in the Acquisitions & Dispositions section above. During the second quarter of 2005, ArcLight Energy Partners Fund I ("Fund I") offered a package of nine of the ROFO projects to Holdings for purchase. Holdings conducted an analysis of the price and terms offered by Fund I and notified Fund I that it was declining to purchase the projects on the terms offered. In late September 2005, ArcLight Fund I entered a purchase and sale agreement with a third party and closed the sale of the projects to that company in December 2005.

As discussed under Contractual Obligations above, the Manager subleases its office space from ArcLight, under an agreement that runs through 2014.

Caithness Energy has an indirect ownership interest in one of the Existing Investors. Subsidiaries of Caithness Energy provide operations and maintenance at four of the Projects and accounting, tax and other administrative functions for 12 of the Projects under agreements which are in effect through 2007 and renewable thereafter. During the year ended December 31, 2005, Holdings incurred fees and expenses of \$2,750 for these services provided by Caithness Energy.

## FINANCIAL AND OTHER INSTRUMENTS

The Company uses forward foreign currency contracts to manage its exposure to changes in foreign exchange rates as the Company earns its income principally in the United States and has the obligation to make distributions predominantly in Canadian dollars. The Company has entered into forward contracts to purchase Canadian dollars at fixed rates of exchange sufficient to make monthly distributions through December 2010 at the current annual distribution level of Cdn. \$1.03 per IPS to all holders including the Existing Investors, as well as interest payments on the separate Subordinated Notes. It is the Company's intention to extend the length of these forward contracts out to five years at or near the end of each year. As planned, changes in the fair market value of the Company's forward contracts partially offset exchange gains or losses on the U.S. dollar equivalent of the Company's Canadian dollar obligations.

For the year ended December 31, 2005, the Company has forward contracts to sell U.S. \$4,645 and receive Cdn. \$5,608 monthly through December 2009. The Company also has forward contracts to sell U.S. \$4,645 and receive Cdn. \$5,209 monthly during 2010. The average rate during the period to December 2009 is \$1.2055 and \$1.1225 during 2010.

The foreign exchange forward contracts are carried at estimated fair value based on quoted market value. Mark-to-market adjustments of the foreign currency forward contracts are reflected in foreign exchange loss. The foreign exchange contracts are classified as other assets.

Certain of the Projects also use interest rate swaps to manage fluctuations in interest rates and natural gas forwards or swaps to minimize the effects to cash flow of changing natural gas prices, which is a major component of project expenses. Some of these contracts have been designated as hedges for accounting purposes. In addition, other projects have entered into natural gas contracts with pricing terms designed to minimize the impact of gas price volatility on operating margins.

## **ACCOUNTING ESTIMATES**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. During the period presented, management has made a number of estimates and valuation assumptions, including the fair values of acquired assets, the useful lives and recoverability of property plant and equipment and power purchase contracts, the recoverability of equity investments, the recoverability of future tax assets and the fair value of financial instruments and derivatives.

The Company has acquired the majority of its long-term assets through acquisitions. In applying the purchase method of accounting, the Company is required to fair value the assets acquired including the property plant and equipment and intangible assets. The determination of these fair values is complex and involves significant judgments. On an ongoing basis, the Company monitors the performance of the facilities to determine if any recoverability issues exist or if any change in the useful life of the facility is required.

The annual audit for 2005 at one of the projects contains a going concern qualification in the Auditor's Letter based on the assessment that the project's debt reserves would likely be utilized over a period of years and, absent changes in the relevant power and electricity markets, might need to renegotiate with its lenders in or around the year 2010. As disclosed at the time of the IPO, the Company is not expecting to receive any distributions from the project until after the debt is retired, as scheduled in 2018. In accordance with GAAP, a review of the recorded value of the project's assets indicated that no economic impairment has occurred as of December 31, 2005. There is a risk that conditions contributing to this assessment could further deteriorate and management will continue to monitor the project closely.

The future tax asset valuation allowance has been determined pursuant to the provisions of CICA 3465, "Income Taxes", including the Company's estimation of future taxable income, where necessary, and is adequate to reduce the total future tax asset to an amount that will more likely than not be realized. The Company has limited operating history. It incurred taxable losses for the taxation period ended December 31, 2004 and the taxable income for the year ended December 31, 2005. The Company does not anticipate generating significant taxable income over the next several years. It is not considered likely that future tax assets will be realized over the next few years. Accordingly, the Company has provided a valuation allowance equivalent to the Company's net future tax assets.

The fair value of financial instruments and derivatives such as the forward foreign currency contracts, interest rate swaps and natural gas swaps are typically based on market quotes. The Company also has Indexed Swap and related hedge agreement as discussed in Note 14 of the audited consolidated financial statements. The fair values of these agreements are based on estimated future cash flows taking into account certain assumptions, including forecasts or future energy prices, inflation rates, discount rates and credit risk. Energy prices can be volatile and other assumptions can change from period to period. These factors can create significant fluctuations in the estimated fair values of these agreements.

Refer to Note 1 of the audited consolidated financial statements for the period ended December 31, 2005.



## **ADOPTION OF ACCOUNTING POLICY**

The Company applies CICA Accounting Guideline 15, "Consolidation of Variable Interest Entities". As a result of applying this guideline, the Company consolidated a variable interest entity for which it is determined to be the primary beneficiary.

## **DISCLOSURE CONTROLS**

As of December 31, 2005, an evaluation was carried out, under the supervision of and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as defined under Multilateral Instrument 52-109. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

## **LITIGATION**

One of Holdings' subsidiaries was previously a partner of Masspower. In July 2005, Masspower and its former partners were named as defendants in a suit filed by the Massachusetts Municipal Wholesale Electric Company ("MMWEC"), which holds a power purchase agreement entitling it to 7.86% of the capacity and energy of the facility. MMWEC alleges that Masspower has, among other things, breached the agreement by restructuring its natural gas contracts without MMWEC's approval. The Masspower partners filed an answer to the suit denying its material allegations. On December 28, 2005, the Masspower partners sold their interest in the facility to a third party. Under the terms of the purchase and sale agreement, the sellers are indemnified by the buyer with respect to any successful claim against Masspower partners that may result from the resolution of the suit, which indemnity is secured by the plant. In addition, the buyer may use a portion of the sale price that was placed in escrow pending the outcome of the litigation process toward defense costs and potential claims. The Company has not recognized in income the \$437 portion of the sales proceeds placed in escrow. Management believes that the settlement of this dispute will have no material impact on the Company.

The Chambers partnership, in which Holdings owns a 40% indirect interest, has filed suit against its coal supplier, CONSOL Pennsylvania Coal Company and related entities, over a disagreement involving the pricing of a portion of the annual coal deliveries to the plant. Chambers seeks, among other things, 1) a declaratory judgment regarding the terms of the agreement, 2) damages for missed deliveries, and 3) injunctive relief to ensure delivery of all coal requested under the contract. The coal supplier has asserted affirmative defenses and counterclaims in its answer and the parties are currently in the discovery process. Although the outcome of the matter is not certain, management believes the coal supplier's affirmative defenses and counterclaims are without merit and the litigation is at too early a stage to estimate exposure.

The Rumford cogeneration facility purchases its coal from Massey Coal Sales Company ("Massey"). Massey's coal is delivered through a Sprague Energy Corp. ("Sprague") marine terminal. Massey and Sprague are disputing terms and compensation for certain terminal services provided by Sprague and Massey asserts that Rumford also has failed to pay certain amounts due under the coal supply agreement. The amounts in dispute are not material and management has not yet formed an expectation regarding the potential outcome of this suit. Massey continues to supply coal to the plant on a timely basis.

## **OUTSTANDING SHARE DATA**

The Company had outstanding 44,339,500 IPSs at March 31, 2006.

## **OUTLOOK**

In order to maintain stable distributions and provide long-term growth, the Company will continue to focus on enhancing the financial performance of the existing Projects and pursuing accretive acquisitions predominantly in the U.S. market.

PPAs in the portfolio have various expirations and, in each case, the project's partners plan for that occurrence by evaluating various options in the market in order to continue maximizing project cash flows. For example, projects with PPA expirations in the 2008-2009 timeframe have already begun to prepare for potential new or extended power purchase arrangements. The new arrangements may involve responses to utility solicitations for capacity, direct negotiations with the original purchasing utility for PPA extensions, or arrangements with creditworthy marketers for tolling agreements, PPAs or the use of derivatives to lock in value. Neither Stone & Webster in its Technical Review nor management assumed that pricing under existing PPAs will necessarily be sustained after PPA expirations.

## **RISK FACTORS**

Atlantic Power's future performance and ability to generate sufficient cash flow to meet its monthly cash distributions to holders of IPSs involves a number of risks and uncertainties. Any of these risks and uncertainties could have a material adverse effect on the Company's results of operations, business prospects, financial condition, the cash available to the Company for distribution to holders of IPSs, Common Shares, or Subordinated Notes or on the market price or value of IPSs, Common Shares or Subordinated Notes. The following is a list of the primary risks facing the Company, with further discussion of risk factors found in the Company's Annual Information Form dated March 30, 2006.

### **REVENUE MAY BE REDUCED UPON EXPIRATION OR TERMINATION OF PPAs**

Power generated by the Projects, in most cases, is sold under PPAs that expire at various times. In addition, these PPAs may be subject to termination in certain circumstances, including default by the Project owner or operator. When a PPA expires or is terminated, it is possible that the price received by the relevant Project for power under subsequent arrangements may be reduced significantly. It is possible that subsequent power purchase arrangements may not be available at prices that permit the operation of the Project on a profitable basis. If this occurs, the affected Project may temporarily or permanently cease operations.

### **THE PROJECTS DEPEND ON THEIR ELECTRICITY AND THERMAL ENERGY CUSTOMERS**

Each Project relies on one or more PPAs, steam sales agreements or other agreements with one or more utilities or other customers for a substantial portion of its revenue. The amount of cash available for distribution to holders of IPSs, Common Shares and Subordinated Notes is highly dependent upon customers under such agreements fulfilling their contractual obligations. There is no assurance that these customers will perform their obligations or make required payments to the Project Operating Entities.

### **CERTAIN PROJECTS ARE EXPOSED TO FLUCTUATIONS IN THE PRICE OF ELECTRICITY**

While a majority of the off-takers of the Projects are contractually obligated to purchase electricity under long-term PPAs, those Projects with power purchase arrangements based on market pricing will be exposed to fluctuations in the wholesale price of electricity. In addition, should any of the long-term PPAs expire or terminate, the Manager or the relevant Project operator will be required to either negotiate new PPAs or sell into the electricity wholesale market, in which case the prices for electricity will depend on market conditions at the time.

### **PREDICTING PROJECT CASH FLOWS OVER THE LONG TERM IS DIFFICULT**

Due to the many uncertainties described in this risk factors section that could materially affect future revenues or expenses, it can be difficult to make long-term projections of the Company's operating margins.

#### OPERATIONS ARE SUBJECT TO THE PROVISIONS OF VARIOUS ENERGY LAWS AND REGULATIONS

Generally, in the United States, the Company's projects are subject to regulation by the Federal Energy Regulatory Commission ("FERC") regarding the terms and conditions of wholesale service and rates, as well as by state agencies regarding PPAs entered into by Qualifying Facilities ("QF") projects and the siting of the generation facilities. The majority of the Company's generation is sold by QF projects under PPAs that required approval by state authorities.

On August 8, 2005, EAct 2005 was enacted, which removed certain regulatory constraints on investment in utility power producers by repealing the Public Utility Holding Company Act of 1935 ("PUHCA 1935") and enacting the Public Utility Holding Company Act of 2005 ("PUHCA 2005"). EAct 2005 also limited the requirement that electric utilities buy electricity from QFs to certain markets that lack competitive characteristics. Finally, EAct 2005 amended and expanded the reach of FERC's corporate merger approval authority under section 203 of the Federal Power Act ("FPA"). Over the last several months, FERC has issued final rulemakings implementing these provisions of EAct 2005.

If any Project that is a QF were to lose its status as a QF, then such Project may no longer be entitled to exemption from provisions of PUHCA 2005 or from provisions of the FPA and state law and regulations. Loss of QF status could trigger defaults under covenants to maintain QF status in the PPAs, steam sales agreements and Project-level debt agreements and result, if not cured within allowed cure periods, in termination of agreements, penalties or acceleration of indebtedness under such agreements, plus interest.

The Projects would also have to file with FERC for market-based rates or file for acceptance for filing of the rates set forth in the applicable PPA and its rates would then be subject to initial and potentially subsequent reviews by FERC under the FPA, which could result in reductions to the rates.

The Company's projects require licenses, permits and approvals which can be in addition to any required environmental permits. No assurance can be provided that we will be able to obtain, comply with and renew as required all necessary licenses, permits and approvals for these facilities. If we cannot comply with and renew as required all applicable regulations, our business, results of operations and financial condition could be adversely affected.

EAct 2005 provides incentives for various forms of electric generation technologies, which may subsidize our competitors. In addition, EAct 2005 requires the FERC to select an industry self-regulatory organization which will impose mandatory reliability rules and standards. Among other things, FERC's rules implementing these provisions allow such reliability organizations to impose sanctions on generators that violate their new reliability rules.

We cannot provide assurance that the introduction of new laws, or other future regulatory developments, will not have a material adverse impact on our business, operations or financial condition.

#### PROJECTS ARE SUBJECT TO SIGNIFICANT AIR EMISSIONS REGULATIONS

Environmental laws and regulations have generally become more stringent over time, and this trend may continue. In particular, the U.S. Environmental Protection Agency, or EPA, has recently promulgated regulations requiring additional reductions in nitrogen oxides, or NO<sub>x</sub> and sulfur dioxide, or SO<sub>2</sub>, emissions, commencing in 2009 and 2010 respectively, and has also promulgated regulations requiring reductions in mercury emissions from coal-fired electric generating units, commencing in 2010 with more substantial reductions in 2018. Moreover, certain of the states in which we operate have promulgated air pollution control regulations which are more stringent than existing and proposed federal regulations. Specifically, there is a proposed multi-state carbon cap-and-trade program known as the Regional Greenhouse Gas Initiative, or RGGI, which would apply to the Company's fossil-fueled facilities in the Northeast. A model rule for implementation of RGGI is expected to be released within the next few months.

#### THE PROJECTS DEPEND ON SUPPLIERS UNDER FUEL SUPPLY AGREEMENTS AND INCREASES IN FUEL COSTS MAY ADVERSELY AFFECT THE PROFITABILITY OF THE PROJECTS

Revenues in respect of the Projects may be affected by the availability, or lack of availability, of a stable supply of fuel at reasonable prices. To the extent possible, the Projects attempt to match fuel costs to PPA energy payments. To the extent that fuel costs are not matched directly to PPA energy payments, increases in fuel costs may adversely affect the profitability of the Projects.

The amount of energy generated at the Projects is highly dependent on suppliers under certain fuel supply agreements fulfilling their contractual obligations. The loss of significant fuel supply agreements or an inability or failure by any supplier to meet its contractual commitments may adversely affect cash distributions by the Company.

Upon the expiry or termination of existing fuel supply agreements, the Manager or Project operators will have to renegotiate these agreements or may need to source fuel from other suppliers. There can be no assurance that the Manager or Project operators will be able to renegotiate these agreements or enter into new agreements on similar terms. Furthermore, there can be no assurance as to availability of the supply or pricing of fuel under new arrangements.

The amount of energy generated at the Projects is dependent upon the availability of natural gas, coal, oil or biomass. There can be no assurance of the long-term availability of such resources.

#### U.S. FEDERAL INCOME TAX RISKS

There can be no assurance that U.S. federal income tax laws and IRS administrative policies respecting the U.S. federal income tax consequences generally applicable to a holder of Common Shares and Subordinated Notes, as represented by IPSs, will not be changed in a manner which adversely affects Non-U.S. Holders.

There is no authority that directly addresses the tax treatment of securities similar to the Subordinated Notes as part of a unit that includes common shares of the Company. In light of this absence of direct authority, it cannot be concluded with certainty that the Subordinated Notes will be treated as debt for U.S. federal income tax purposes, and, although the Company intends to take the position that the Subordinated Notes are debt for U.S. federal income tax purposes, there can be no assurance that this position will not be challenged by the IRS. If such a challenge were sustained, interest payments on the Subordinated Notes would be re-characterized as non-deductible distributions with respect to the Company's equity, and the Company's net taxable income and thus its U.S. federal income tax liability would be materially increased. As a result, the Company's after-tax cash flow would be reduced and the Company's ability to make interest payments on Subordinated Notes and distributions with respect to Common Shares could be materially and adversely impacted.

#### ADDITIONAL INFORMATION

Additional information is available on the Company's website at [www.atlanticpowercorporation.com](http://www.atlanticpowercorporation.com), or at [www.sedar.com](http://www.sedar.com).

Supplementary Information for the Year Ended December 31, 2005 (unaudited)

	Consolidated and Proportionately Consolidated Projects	Proportionate Consolidation of Equity Investments*	Corporate
<b>Income Statement</b>			
Project revenue			
Energy sales	173,841	149,370	-
Indexed swap	6,339	-	-
Other	4,520	7,858	-
	184,700	157,228	-
Project expenses			
Fuel	71,346	94,092	-
Operations and maintenance	30,158	18,589	-
Project operator fees and expenses	6,409	8,769	-
Amortization	36,280	20,088	-
	144,193	141,538	-
Project other income and (expenses)			
Interest expense, net	( 5,712)	( 6,433)	-
Other income	-	5,015	-
Income tax expense	-	( 811)	-
	( 5,712)	( 2,229)	-
Project income	34,795	13,461	-
Administrative and other expenses			
Management fees and administration	-	-	5,095
Amortization of deferred financing costs	-	-	990
Interest, net	-	-	23,698
Distribution, non-controlling interest	-	-	20,578
Change in fair value of non-controlling interest	-	-	(6,404)
Gain on settlement of non-controlling interest	-	-	(4,184)
Foreign exchange (gain) loss	-	-	6,453
	-	-	46,226
Net income before tax	34,795	13,461	(46,226)
Current income tax expense	-	-	2,539
Net income	34,795	13,461	(48,765)

\* Non-GAAP measure showing composition of revenues and expenses based on Company's share of the Projects accounted for under the equity method.

Supplementary Information for the Year Ended December 31, 2005 (unaudited)

	Consolidated and Proportionately Consolidated Projects	Proportionate Consolidation of Equity Investments*	Corporate
<b>Assets</b>			
Current assets			
Cash and cash equivalents	21,784	5,680	11,566
Reserve fund	-	-	10,508
Restricted cash	26,758	16,673	-
Current portion of indexed swap	46,558	-	-
Accounts receivable	28,596	12,328	112
Prepayments, supplies and other	7,573	4,568	329
Income tax receivable	-	-	7,682
	131,269	39,249	30,197
Property, plant, and equipment			
Property, plant, and equipment	428,479	70,195	-
Power purchase and other contracts	174,677	73,000	-
Long-term portion of indexed swap	61,356	-	-
Deferred financing costs	234	-	10,409
Other	1,462	977	10,212
	797,477	183,421	50,818
<b>Liabilities and Shareholders' Equity</b>			
Current liabilities			
Accounts payable and accrued liabilities	27,108	12,285	894
Revolving credit facility	-	-	10,000
Current portion of long-term debt	21,558	8,142	-
Current portion of indexed swap hedge	25,094	-	-
Interest payable on Subordinated Notes	-	-	2,303
Distribution payable, non-controlling interest	-	-	1,429
Dividends payable	-	-	1,258
Other	3,719	-	-
	77,479	20,427	15,884
Long-term debt			
Long-term debt	224,482	79,473	-
Other liabilities, non-controlling interest	-	-	169,479
Subordinated Notes	-	-	251,844
Indexed swap hedge	33,453	-	-
Other liabilities	39,827	5,186	-
	375,241	105,086	437,207
<b>Shareholders' equity</b>			
Common stock	-	-	148,025
Project equity	422,236	78,335	(500,571)
Retained earnings (deficit)	-	-	(33,843)
Total shareholders' equity	422,236	78,335	(386,389)
	797,477	183,421	50,818

\* Non-GAAP measure showing composition of the assets and liabilities based on Company's share of the Projects accounted for under the equity method.

Project EBITDA (in thousands of U.S. dollars)

Periods Ended (Unaudited)	3 Months Ended December 31, 2005	12 Months Ended December 31, 2005
<b>EBITDA from consolidated and proportionately consolidated projects</b>		
Badger Creek	1,176	4,656
Chambers	7,152	9,058
Koma Kulshan	245	694
Lake	7,217	25,957
Mid-Georgia	1,769	5,251
Onondaga	(427)	3,939
Orlando	3,204	8,998
Pasco	3,836	13,782
Stockton	586	2,577
Topsham	560	1,449
Other	-	426
Total EBITDA from consolidated and proportionately consolidated projects	25,318	76,787
Amortization	13,607	36,280
Interest expense, net	1,139	5,712
Consolidated and proportionately consolidated project earnings, net	10,572	34,795
<b>EBITDA from equity projects</b>		
Delta-Person	484	1,984
Gregory	1,307	5,278
Jamaica	607	3,935
Masspower	(298)	3,186
Rumford	1,861	7,238
Selkirk	801	14,281
Other	71	(124)
Total EBITDA from equity accounted projects	4,833	35,778
Amortization	9,162	20,088
Interest expense, net	843	6,433
Gain on disposal of equity investment	(2,405)	(5,015)
Other expense	146	811
Equity earnings, net	(2,913)	13,461
Total consolidated and proportionately consolidated project earnings, net	10,572	34,795
Total equity earnings, net	(2,913)	13,461
Project Income	7,659	48,256

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

to the Shareholders of Atlantic Power Corporation

The accompanying consolidated financial statements for Atlantic Power Corporation, the management discussion and analysis, and the information included in this annual report have been prepared by Atlantic Power Management, LLC, the Corporation's management who are responsible for their consistency, integrity and objectivity. Management is also responsible for ensuring that the consolidated financial statements are prepared and presented in accordance with Canadian generally accepted accounting principles, which include amounts that are based on estimates and judgments. To fulfill these responsibilities, management maintains appropriate internal control systems and policies and procedures to provide reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements.

KPMG LLP, the Corporation's independent auditor, is responsible for auditing the consolidated financial statements in accordance with Canadian generally accepted accounting procedures, and has expressed their opinion on the consolidated financial statements in this report. Their report, as auditors, is set forth herein.

The Corporation's Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board of Directors carries out this responsibility through its Audit Committee which meets regularly with management and the independent auditors. The members of the Audit Committee are independent of management. The consolidated financial statements have been reviewed and approved by the Board of Directors and its Audit Committee. The independent auditors have direct and full access to the Audit Committee and the Board of Directors.



**BARRY WELCH**

*President*



**MARK BYSKOV**

*Chief Financial Officer*

## AUDITORS' REPORT

to the Shareholders of Atlantic Power Corporation

We have audited the consolidated balance sheets of Atlantic Power Corporation as at December 31, 2005 and 2004 and the consolidated statements of operations and deficit and cash flows for the year December 31, 2005 and period from November 18, 2004 to December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the year December 31, 2005 and period from November 18, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.



**CHARTERED ACCOUNTANTS**

*Toronto, Canada March 31, 2006*



## Consolidated Balance Sheets (in thousands of U.S. dollars)

December 31	2005	2004
<b>ASSETS</b>		
<i>Current assets:</i>		
Cash and cash equivalents	\$ 33,350	\$ 22,663
Reserve fund	10,508	12,509
Restricted cash	26,758	28,971
Current portion of indexed swap (note 14)	46,558	29,899
Accounts receivable	28,708	17,522
Prepayments, supplies and other	7,902	4,771
Income tax receivable	7,682	-
	<b>161,466</b>	<b>116,335</b>
Property, plant and equipment (note 4)	428,479	293,988
Equity investments (note 5)	78,335	139,696
Intangible assets (note 6)	174,677	105,914
Long-term portion of indexed swap (note 14)	61,356	69,692
Deferred financing costs	10,643	11,399
Other	11,674	3,179
	<b>\$ 926,630</b>	<b>\$ 740,203</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<i>Current liabilities:</i>		
Accounts payable and accrued liabilities	\$ 28,002	\$ 17,780
Revolving credit facility (note 7)	10,000	-
Current portion of long-term debt (note 8)	21,558	13,764
Current portion of indexed swap hedge (note 14)	25,094	7,320
Interest payable on subordinated notes	2,303	2,719
Distribution payable, non-controlling interest	1,429	2,622
Dividends payable	1,258	1,338
Other	3,719	4,714
	<b>93,363</b>	<b>50,257</b>
Long-term debt (note 8)	224,482	85,302
Subordinated notes (note 9)	251,844	206,927
Other liabilities, non-controlling interests (note 10)	169,479	236,928
Indexed swap hedge (note 14)	33,453	22,973
Other liabilities	39,827	37,667
<i>Shareholders' equity:</i>		
Common stock (note 11)	148,025	121,381
Deficit	(33,843)	(21,232)
	<b>114,182</b>	<b>100,149</b>
Commitments and contingencies (note 13)		
	<b>\$ 926,630</b>	<b>\$ 740,203</b>

See accompanying notes to consolidated financial statements.

On behalf of the Board:



**KEN HARTWICK**  
Director



**IRVING GERSTEIN**  
Director

Consolidated Statements of Operations and Deficit (in thousands of U.S. dollars, except per share amounts)

Year ended December 31, 2005 and period from November 18, 2004 to December 31, 2004	2005	2004
<i>Project revenue:</i>		
Energy sales	\$ 173,841	\$ 16,628
Indexed swap (note 14)	6,339	1,274
Other	4,520	588
	<b>184,700</b>	<b>18,490</b>
<i>Project expenses:</i>		
Fuel	71,346	6,865
Operations and maintenance	30,158	3,389
Project operator fees and expenses (note 15)	6,409	743
Amortization	36,280	3,579
	<b>144,193</b>	<b>14,576</b>
<i>Project other income (expense):</i>		
Equity earnings, net (note 5)	8,446	593
Interest expense, net	(5,712)	(868)
Gain on disposal of equity investment	5,015	-
	<b>7,749</b>	<b>(275)</b>
Project income	<b>48,256</b>	<b>3,639</b>
<i>Administrative and other expenses:</i>		
Management fees and administration (note 15)	5,095	1,270
Amortization of deferred financing costs	990	116
Interest, net	23,698	2,769
Distribution, non-controlling interest	20,578	2,622
Change in fair value of non-controlling interest (note 10)	(6,404)	16,490
Gain on settlement of non-controlling interest	(4,184)	-
Foreign exchange loss	6,453	266
	<b>46,226</b>	<b>23,533</b>
Income (loss) before income taxes	<b>2,030</b>	<b>(19,894)</b>
Income taxes (note 12)	<b>2,539</b>	<b>-</b>
Loss for the period	<b>(509)</b>	<b>(19,894)</b>
Deficit, beginning of period	<b>(21,232)</b>	<b>-</b>
Dividends	<b>(12,102)</b>	<b>(1,338)</b>
Deficit, end of period	<b>\$ (33,843)</b>	<b>\$ (21,232)</b>
Basic loss per share (note 17)	<b>\$ 0.01</b>	<b>\$ 0.57</b>

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows (in thousands of U.S. dollars)

Year ended December 31, 2005 and period from November 18, 2004 to December 31, 2004	2005	2004
<b>CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES:</b>		
Loss for the period	\$ (509)	\$ (19,894)
<i>Items not involving cash:</i>		
Amortization	37,270	3,695
Equity earnings	(8,446)	(593)
Gain on settlement of non-controlling interest	(4,184)	-
Change in fair value of non-controlling interest	(6,404)	16,490
Amortization of gas transportation contracts	(7,300)	(540)
Foreign exchange loss	8,281	266
Market value adjustments on indexed swap and hedge	(6,339)	(1,274)
Amortization of other liabilities and deferred revenue	1,959	(417)
Change in fair value of interest rate swaps	(4,432)	-
Gain on disposal of equity investment	(5,015)	-
Future income taxes	(6,420)	-
Other	369	-
Change in non-cash operating working capital	(2,654)	7,612
Indexed swap and hedge settlements	26,270	3,878
Distributions from equity investments	15,924	3,674
	<b>38,370</b>	<b>12,897</b>
<b>CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	26,644	128,974
Proceeds from issuance of Subordinated Notes	37,730	205,934
Equity issuance costs	-	(7,593)
Deferred financing costs	(239)	(11,515)
Proceeds from draw on revolving credit facility	25,000	-
Repayment of revolving credit facility	(15,000)	-
Repayment of long-term debt	(20,679)	(3,410)
Repayment of assumed debt on acquisition	-	(167,831)
Dividends paid	(12,182)	-
Repayment of obligations to non-controlling interest	(64,374)	(39,742)
	<b>(23,100)</b>	<b>104,817</b>
<b>CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES:</b>		
Proceeds on disposal of equity investment	59,365	-
Acquisitions, net of cash acquired (note 2)	(63,391)	(83,275)
Purchase of property, plant and equipment	(2,558)	(86)
Proceeds on disposal of property, plant and equipment	-	77
Change in reserve fund	2,001	(12,509)
Other	-	742
	<b>(4,583)</b>	<b>(95,051)</b>
Increase in cash and cash equivalents	<b>10,687</b>	<b>22,663</b>
Cash and cash equivalents, beginning of period	<b>22,663</b>	-
Cash and cash equivalents, end of period	\$ <b>33,350</b>	\$ 22,663
Supplemental cash flow information:		
Interest paid	\$ 35,958	\$ 1,003
Equity issued to non-controlling interest (note 2)	-	259,082

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 2005 and period from November 18, 2004 to December 31, 2004  
(in thousands of U.S. dollars)

Atlantic Power Corporation (the “Company”) is a corporation established under the laws of the Province of Ontario on June 18, 2004 and continued to the Province of British Columbia on July 8, 2005. The Company issued Income Participating Securities (“IPs”) for cash pursuant to an initial public offering on November 18, 2004. Prior to November 18, 2004, the Company was inactive.

The Company has indirect interests in 15 power generation projects located primarily in the United States of America (collectively, the “Projects”). Two of the Projects are wholly owned subsidiaries of the Company, being Onondaga Cogeneration Limited Partnership (“Onondaga”) and Lake Cogen Ltd. (“Lake”).

The Projects are primarily “Qualifying Facilities” (“QFs”) and “exempt wholesale generators” (“EWGs”), which have long-term contracts to sell power. QFs are small power producers or cogenerators (power producers that produce steam as a by-product of the electricity-generating process for use in a second industrial process) that meet certain operating, efficiency and fuel use standards set forth by the United States’ Federal Energy Regulatory Commission (“FERC”).

## 1. SIGNIFICANT ACCOUNTING POLICIES

### A. BASIS OF CONSOLIDATION

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) and include the consolidated accounts of all of its subsidiaries. The Company uses equity accounting for investments in which it has significant influence but does not control. The Company proportionately consolidates investments in which it has joint control. The Company eliminates intercompany accounts and transactions.

In June 2003, The Canadian Institute of Chartered Accountants (“CICA”) issued Accounting Guideline 15, “Consolidation of Variable Interest Entities” (“AcG-15”). AcG-15 addresses the application of consolidation principles to certain entities that are subject to control on a basis of control other than ownership of voting interests. AcG-15 addresses when an enterprise should include the assets, liabilities and results of activities of such an entity in its consolidated financial statements. The Company adopted AcG-15 on a retroactive basis. The adoption had no impact on opening deficit. The Company has one variable interest entity acquired during 2005 (note 2(b)).

### B. CASH AND CASH EQUIVALENTS, RESERVE FUND AND RESTRICTED CASH

Cash and cash equivalents include cash deposited at banks and highly liquid investments with original maturities of three months or less.

The reserve fund represents short-term investments and cash that management has set aside to support future distributions and to use in part to make acquisitions.

Restricted cash represents cash and short-term investments maintained in accounts administered by a separate agent as required under certain Projects’ debt agreements.

### C. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, net of accumulated amortization. Amortization is provided on a straight-line basis over the estimated useful life of the related asset. The amortization period for facilities ranges from nine to 33 years. The weighted average period of amortization is 23 years.

### D. INTANGIBLE ASSETS

Intangible assets include power purchase contracts, fuel supply agreements and licenses and rights.

Power purchase contracts are valued at the time of acquisition based on the rates received under the power purchase contracts relative to projected market rates. The balances are net of accumulated amortization. Amortization is provided on a straight-line basis over the remaining term of the contract. The amortization period ranges from three to 19 years. The weighted average period of amortization is 10 years.

Fuel supply agreements are valued at the time of acquisition based on the rates projected to be paid under the fuel supply agreement relative to projected market rates. The amortization period ranges from four to 18 years. The weighted average period of amortization is 10 years.

Licenses and rights are valued at the time of acquisition based on the estimated value. Amortization is provided on a straight-line basis over the remaining benefit period of the licenses and rights.

#### E. REVENUE RECOGNITION

Generally, the Company recognizes revenue when electricity and steam are delivered under the terms of the related contracts. If the power purchase contract has pricing that fluctuates over the term of the contract then the Company recognizes revenue based on the estimated average rate for the duration of the contract with the difference between cash received and revenue recognized reflected as deferred revenue.

Onondaga recognizes revenue as the swap agreements it has entered settle monthly, net of any change in fair value on these swap agreements (note 14).

#### F. INCOME TAXES

Income taxes are accounted for using the asset and liability method. Future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the year that includes the date of enactment or substantive enactment.

A valuation allowance is recorded against future tax assets to the extent that it is more likely than not that the future tax asset will not be realized.

#### G. GAS TRANSPORTATION CONTRACTS

Onondaga has certain long-term commitments for the provision of natural gas transportation service to the Onondaga project through the year 2013. The contracts all provide for fixed monthly demand charges, in addition to variable commodity charges based on the quantity of gas transported. Obligations related to the long-term gas transportation agreements were recognized as liabilities in purchase accounting upon the acquisition of Onondaga by the Company. These obligations are being relieved over the remaining lives of the contracts.

All of the Company's other gas transportation costs are expensed as incurred.

#### H. ACCOUNTING FOR DERIVATIVES

The Company uses financial derivative agreements in the form of interest rate swaps and foreign exchange forward contracts to manage its current and anticipated exposure to fluctuations in interest rates and foreign currency exchange rates. On occasion, the Company has also entered into natural gas supply contracts and natural gas forwards or swaps to minimize the effects of the price volatility of natural gas which is a major production cost. The Company does not enter into financial derivative agreements for trading or speculative purposes; however, not all derivatives qualify for hedge accounting.

The Company follows Accounting Guideline 13, "Hedging Relationships" ("AcG-13"), issued by CICA, which addresses the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting and provides guidance with respect to the discontinuance of hedge accounting. Derivative financial instruments not designated within an AcG-13 compliant hedging relationship are measured at fair value with changes in fair value recorded in the consolidated statements of operations and deficit. Derivative financial instruments not designated as hedges are the foreign currency forward contracts, the indexed swap and the indexed swap hedge agreements and certain interest rate swaps. Mark-to-market adjustments of the foreign currency forward contracts are reflected in foreign exchange loss, indexed swap and indexed swap hedge agreements are netted and reflected as indexed swap under project revenue and adjustments of interest rate swaps are reflected in project interest expense in the consolidated statements of operations.

Effectiveness tests are performed to evaluate hedge effectiveness at inception and on an ongoing basis, both retroactively and prospectively. Unrealized gains or losses on the interest rate swaps designated within a compliant AcG-13 relationship are not recognized.

Gains and losses on natural gas forward contracts and swaps which are designated as a hedge of fuel costs are recognized in income as actual fuel costs are recognized.

Natural gas supply contracts in the normal course of business in which the Company takes possession of the natural gas are treated as executory contracts.

#### I. ASSET RETIREMENT OBLIGATIONS

The fair value of estimated asset retirement obligations is recognized in the consolidated balance sheet when identified and a reasonable estimate of fair value can be made. The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. The asset retirement costs are amortized over the asset's estimated useful life and included in amortization expense in the consolidated statements of operations and deficit. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation in the consolidated statements of operations and deficit. Actual expenditures incurred are charged against the accumulated obligation.

#### J. LONG-LIVED ASSETS

Long-lived assets, such as property, plant and equipment and intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset.

#### K. DEFERRED FINANCING COSTS

Deferred financing costs consist of loan fees and other costs of financing that are amortized over the term of the related financing using the straight-line method. The amortization period is the term of the debt.

#### L. FOREIGN CURRENCY TRANSLATION

The Company's functional currency and reporting currency is the United States dollar. The functional currency of the Company's subsidiaries and other investments is the United States dollar. Monetary assets and liabilities denominated in Canadian dollars are translated into United States dollars using the rate of exchange in effect at the end of the year. All transactions denominated in Canadian dollars are translated into United States dollars at the exchange rates in effect at the transaction date. Foreign currency translation gains and losses are reflected in the consolidated statements of operations and deficit.

#### M. USE OF ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates. During the periods presented, management has made a number of estimates and valuation assumptions, including the fair values of acquired assets, the useful lives and recoverability of property, plant and equipment and power purchase contracts, the recoverability of equity investments, the recoverability of future tax assets, and the fair value of financial instruments and derivatives. These estimates and valuation assumptions are based on present conditions and management's planned course of action, as well as assumptions about future business and economic conditions. Should the underlying valuation assumptions and estimates change, the recorded amounts could change by a material amount.

## N. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

## 2. ACQUISITIONS

The Company formed Atlantic Power Holdings, LLC (“Atlantic Holdings”), a Delaware limited liability company, for the purpose of acquiring indirect interests in 15 Projects from Teton Power Holdings, LLC, Epsilon Power Holdings, LLC and Umatilla Power Holdings, LLC (the “Existing Investors”) and acquired the interests of the Existing Investors in the Projects that were held by their wholly owned subsidiaries.

### A. ADJUSTMENT OF 2004 ACQUISITION

On November 18, 2004, the Company acquired for total consideration of \$522,638 (including \$1,014 in acquisition costs) an indirect interest in 15 projects located primarily in the United States of America. During the year ended December 31, 2005, the fair value of certain projects was finalized. The purchase price allocation has been adjusted as follows:

	Preliminary purchase equation	Adjustments	Revised purchase equation
Working capital	\$ 47,213	\$ 577	\$ 47,790
Equity investments	142,777	467	143,244
Property, plant and equipment	296,132	6,002	302,134
Intangible assets	107,340	1,175	108,515
Indexed swap and hedge, net	71,902	-	71,902
Other liabilities	(2,242)	(991)	(3,233)
Long-term debt	(102,476)	(810)	(103,286)
Gas transportation contracts	(38,008)	-	(38,008)
Future tax liability	-	(6,420)	(6,420)
Total purchase price	522,638	-	522,638
Less repayment of assumed debt	167,831	-	167,831
	354,807	-	354,807
Less cash acquired	12,000	-	12,000
	\$ 342,807	\$ -	\$ 342,807
Consideration represented by:			
Cash paid, net of cash acquired	\$ 83,725	\$ -	\$ 83,725
Non-controlling interest liability (note 10)	259,082	-	259,082
	\$ 342,807	\$ -	\$ 342,807

## B. EPSILON POWER PARTNERS, LLC ACQUISITION

On September 8, 2005, the Company acquired Epsilon Power Partners, LLC (“Epsilon”) for cash consideration of \$65,008 including acquisition costs of \$564. Epsilon owns a 40% interest in Chambers Cogeneration LP (“Chambers”), the owner and operator of a 262 megawatt pulverized coal-fired cogeneration facility located at E.I. DuPont de Nemours & Company’s Chambers Works complex in southwestern New Jersey. The purchase price has been allocated as follows:

Working capital	\$	9,541
Property, plant and equipment		142,817
Intangible assets		87,258
Other liabilities		(7,766)
Long-term debt		(166,842)
<hr/>		
Total purchase price		65,008
Less cash acquired		1,617
<hr/>		
Cash paid, net of cash acquired	\$	63,391

The property, plant and equipment will be amortized over its remaining life estimated as 23 years. The intangible assets will be amortized over periods ranging from 18 years to 23 years.

The Company remains in the process of finalizing its purchase price allocation and the tax basis of the assets acquired.

## C. PROJECT ACQUISITION

During the year ended December 31, 2005, Atlantic Holdings increased its interest in one of its existing projects. The fair value of the interest acquired by the Company was \$1,074 and was financed by cash consideration at the project level.

## 3. JOINT VENTURE INVESTMENTS

The Company accounts for eight entities under proportionate consolidation. Chambers was acquired in 2005 (note 2(b)).

Entity name	Proportion consolidated
Badger Creek Limited	50.0%
Chambers	40.0%
Koma Kulshan Associates	50.0%
Mid-Georgia Cogen LP	50.0%
Orlando Cogen Limited LP	50.0%
Pasco Cogen Ltd.	49.9%
Stockton Cogen Company	50.0%
Topsham Hydro Assets	50.0%

The following summarizes the balance sheet at December 31, 2005 and 2004 and, operating results and distributions for the year ended December 31, 2005 and the period from November 18, 2004 to December 31, 2004 for the Company’s proportionate share for the eight entities:



Company's share

	2005	2004
<b>ASSETS</b>		
Current assets	\$ 64,776	\$ 43,658
Non-current assets	526,761	231,390
	\$ 591,537	\$ 275,048
<b>LIABILITIES</b>		
Current liabilities	\$ 46,940	\$ 23,857
Non-current liabilities	243,552	87,238
	\$ 290,492	\$ 111,095
Operating results:		
Revenue	\$ 126,989	\$ 11,953
Net income	9,231	1,262
Distributions	\$ 19,107	\$ 6,700

#### 4. PROPERTY, PLANT AND EQUIPMENT

	2005	2004
Cost	\$ 447,595	\$ 296,141
Less accumulated amortization	19,116	2,153
	\$ 428,479	\$ 293,988

*Amortization expense of \$16,886 (2004 - \$2,153) was expensed during the year.*

#### 5. EQUITY INVESTMENTS

The Company has an investment in five entities accounted for under the equity method. The entities are Delta-Person Limited Partnership, Gregory Power Partners LP, Jamaica Private Power Limited Company, Rumford Cogeneration Company LP and Selkirk Cogen Partners LP. The Company owns its interests in Gregory Power Partners LP and a portion of its interest in Rumford Cogeneration Company LP through Javelin Energy LLC. On December 28, 2005, the Company sold its interest in for proceeds of \$59,365 realizing a gain on disposition of \$5,015. An analysis of the investments is presented below:

	2005	2004
Equity investments, beginning of period (note 2)	\$ 139,696	\$ 142,777
Adjustment to purchase price allocations (note 2)	467	-
Disposal of equity investment	(54,350)	-
Equity earnings, net	8,446	593
Distributions received	(15,924)	(3,674)
Equity investments, end of period	\$ 78,335	\$ 139,696

The fair value increment on acquisition of the investments has been allocated to property, plant and equipment and intangible assets.

## 6. INTANGIBLE ASSETS

Intangible assets include power purchase agreements, fuel supply agreements and licenses and rights.

	2005	2004
Power purchase agreements	\$ 14,832	\$ 107,340
Fuel supply agreements	110,403	-
Licenses and rights	70,538	-
	<b>195,773</b>	107,340
Less accumulated amortization	21,096	1,426
	<b>\$ 174,677</b>	\$ 105,914

*Amortization expense of \$19,670 (2004 - \$1,426) was expensed during the year.*

## 7. CREDIT FACILITY

The Company has a \$75,000 revolving credit facility maturing November 18, 2007, which bears interest at a rate equal to LIBOR or U.S. Base Rate, plus an applicable margin to those rates. At December 31, 2005, \$10,000 was drawn and an additional \$15,061 (2004 - \$14,750) was allocated, but not drawn to support letters of credit. The Company has to meet certain financial covenants. The facility is secured by pledges of assets and interests in certain subsidiaries and Projects.

## 8. LONG-TERM DEBT

	2005	2004
Project debt of joint ventures, interest ranging from 3.25% to 9.125%, expiring between 2006 and 2018	\$ 246,040	\$ 99,066
Less current portion of project debt of joint ventures	21,558	13,764
	<b>\$ 224,482</b>	\$ 85,302

Principal payments due under the terms of non-recourse financing at the Projects in the next five years and thereafter are as follows:

2006	\$ 21,558
2007	24,022
2008	24,376
2009	15,379
2010	15,320
Thereafter	145,385
	<b>\$ 246,040</b>

The Project debt of joint ventures is secured by the respective facility and its contracts with no other recourse to the Company. The loans have certain financial covenants which must be met.

## 9. SUBORDINATED NOTES

	2005	2004
Subordinated Notes (Cdn. \$292,207; 2004 - Cdn. \$248,727)	\$ 251,844	\$ 206,927

The Company issued \$176,560 of 11% Subordinated Notes in conjunction with its initial public offering of IPSs (note 10) and \$30,367 of 11% Subordinated Notes separately. In connection with the October 3, 2005 issuance of IPSs, the Company issued an additional \$37,730 of 11% Subordinated Notes. The proceeds of \$37,730 include a premium of \$605 which is being amortized over the term of the notes. The Subordinated Notes will mature in 2016 subject to redemption under specified conditions at the option of the Company, commencing on or after November 18, 2009. Interest is payable monthly in arrears and the principal repayment will occur at maturity. The Subordinated Notes are secured by a subordinated pledge of the Company's interest in Atlantic Holdings and contain certain restrictive covenants.

## 10. OTHER LIABILITIES, NON-CONTROLLING INTEREST

The net proceeds from the private placement were used by the Company to increase its common membership ownership in Atlantic Holdings from 58.1% to 70.1%. Atlantic Holdings concurrently redeemed membership interests held indirectly by the Existing Investors, reducing the Existing Investors' common membership ownership from 41.9% to 29.9%.

As of December 31, 2005, the Existing Investors have a 29.9% (2004 – 41.9%) interest in Atlantic Holdings and also have the right to request, at any time, that Atlantic Holdings purchase for cancellation all or any portion of the Existing Investors' interests in Atlantic Holdings, subject to a minimum remaining 10% interest for a two-year period from November 18, 2004. The repurchase of the Existing Investors' interests is conditional upon Atlantic Holdings being able, after utilizing its best efforts, to complete or cause the completion of an equity financing on terms acceptable to the managers of Atlantic Holdings who are independent of the Existing Investors and their affiliates, acting reasonably, to secure the necessary funds to enable it to purchase the Existing Investors' interests. Atlantic Holdings may only finance repurchases of Existing Investors' interests pursuant to the exercise of the rights by issuing additional equity securities. This may occur through the sale of equity interests to the Company, the purchase of which by the Company may be financed by a sale of IPSs or other equity securities of the Company. This liquidity right is treated as a liability of the Company and is recorded at fair value on the consolidated balance sheet. To purchase the remaining 29.9% interest, 22,283,721 IPSs would be required to be issued. Existing Investors must hold a minimum 10% interest in Atlantic Holdings until November 18, 2006.

Any change in fair value of the non-controlling interest is recognized in the consolidated statements of operations and deficit as a change in fair value of non-controlling interest. For the period ended December 31, 2005, a gain of \$6,404 (2004 – a cost of \$16,490) is reflected in the consolidated statements of operations and deficit.

## 11. SHARE CAPITAL

	Number		Amount
	(000s)		
Issuance of common stock, initial public offering	32,000	\$	105,549
Issuance of common stock	4,800		15,832
Balance, December 31, 2004	36,800		121,381
Issuance of common stock	7,539		26,644
Balance, December 31, 2005	44,339	\$	148,025

The Company issued 32,000,000 IPSs for cash pursuant to its initial public offering on November 18, 2004 and a further 4,800,000 IPSs on December 6, 2004. Each IPS was issued for Cdn. \$10.00. Each IPS consists of one common share of the Company and Cdn. \$5.767 of aggregate principal amount of 11% Subordinated Notes of the Company (note 9). Proceeds of \$121,381 (net of offering costs of \$7,593) were allocated to common stock.

On October 3, 2005, the Company issued 7,539,000 IPSs at a rate of Cdn. \$10.00 per IPS to Caisse de dépôt et placement du Québec and certain officers of the Company in a secondary private placement. Proceeds of \$26,644 (net of offering costs of \$64) were allocated to common stock.

## 12. INCOME TAXES

	2005		2004
Current income tax expense	\$ 8,959	\$	-
Future income tax expense (recovery)	(6,420)		-
	\$ 2,539	\$	-

The following is a reconciliation of income taxes calculated at the Canadian enacted statutory rate (36.12%) to the provision for income taxes in the consolidated statements of operations and deficit.

	2005		2004
Computed income tax expense at Canadian statutory rate	\$ 733	\$	(7,186)
Increase (decrease) resulting from:			
Operating in countries with different income tax rates	58		(164)
	791		(7,350)
Valuation allowance	21,547		357
	22,338		(6,993)
Non-taxable foreign-source income	(904)		-
Canadian loss carryforwards	(12,996)		-
Branch profits tax	739		-
Prior year true-up	(6,420)		-
Other	(218)		6,993
	(19,799)		6,993
Income tax expense	\$ 2,539	\$	-

The tax effect of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2005 are presented below:

	2005		2004
<b>FUTURE TAX ASSETS</b>			
Intangible assets	\$ 8,849	\$	8,629
Loss carryforwards	12,996		690
Gas transportation contract and other accrued liabilities	13,321		-
Unrealized foreign exchange loss on subordinated notes	3,427		-
Other	2,702		2,168
Total future tax assets	41,295		11,487
Valuation allowance	(21,904)		(357)
	19,391		11,130
<b>FUTURE TAX LIABILITIES</b>			
Property, plant and equipment	15,682		10,336
IPS issuance costs	-		176
Unrealized foreign exchange gain	2,858		-
Other	851		618
Total future tax liabilities	19,391		11,130
Net future tax asset (liability)	\$ -	\$	-

As of December 31, 2005, the Company has the following net operating loss carryforwards that are scheduled to expire in the following years:

2014	\$	5,504
2015		30,476
	\$	35,980

These losses relate to the Canadian entity and may only be used to offset the future income of the Canadian entity for Canadian income tax purposes. A full valuation allowance was taken against the future tax assets set up in respect of the Canadian entity's loss carryforwards as the Company believes that it is not more likely than not that the Canadian entity would be able to use any of these loss carryforwards.

### 13. COMMITMENTS AND CONTINGENCIES

- a. In the normal course of business, the Projects may be involved in litigation from time to time.
- i. In July 2005, Masspower and its former partners, including a subsidiary of the Company, were named as defendants in a suit filed by the Massachusetts Municipal Wholesale Electric Company ("MMWEC"), which holds a power purchase agreement entitling it to 7.86% of the capacity and energy of the facility. MMWEC alleges that Masspower has, among other things, breached the agreement by restructuring its natural gas contracts without MMWEC's approval. The Masspower partners filed an answer to the suit denying its material allegations. On December 28, 2005, the Masspower partners sold their interest in the facility to a third party. Under the terms of the purchase and sale agreement, the sellers are indemnified by the buyer with respect to any successful claim against the Masspower partners that may result from the resolution of the suit, which indemnity is secured by the plant. In addition, the buyer may use a portion of the sale price that was placed in escrow pending the outcome of the litigation process toward defence costs and potential claims. The Company has not recognized in income the portion of the sales proceeds placed in escrow on the sale of Masspower of \$437. Management of the Company believes that the settlement of this dispute will have no material impact to the Company.
  - ii. Chambers, in which the Company owns a 40% indirect interest, has filed suit against its coal supplier, CONSOL Pennsylvania Coal Company and related entities, over a disagreement involving the pricing of a portion of the annual coal deliveries to the plant. Chambers seeks, among other things, 1) a declaratory judgement regarding the terms of the agreement, 2) damages for missed deliveries, and 3) injunctive relief to ensure delivery of all coal requested under the contract. The coal supplier has asserted affirmative defences and counterclaims in its answer, including claims of unjust enrichment and fraud, and the parties are currently in the discovery process. On December 1, 2005, Chambers moved to dismiss the claims of fraud and unjust enrichment, as well as making requests for punitive damages should the fraud claim be dismissed. An order on the Chambers motion is pending. Management of the Company believes the coal supplier's affirmative defences and counterclaims are without merit and the situation is at too early a stage to estimate exposure. The coal supplier is continuing to supply coal.
  - iii. The Rumford cogeneration facility purchases its coal from Massey Coal Sales Company ("Massey"). Massey's coal is delivered through a Sprague Energy Corp. ("Sprague") marine terminal. Massey and Sprague are disputing terms and compensation for certain terminal services provided by Sprague. Massey asserts that Rumford also has failed to pay certain amounts due under the coal supply agreement. The amounts in dispute are not material and management has not yet formed an expectation regarding the potential outcome of this suit. Massey continues to supply coal to the plant on a timely basis.

b. Certain projects have long-term contracts for supply and transportation of fuel. The contracts may have minimum volumetric commitments of delivery, but these obligations are non-recourse to the Company.

c. One of Company's proportionately consolidated joint ventures contains a going concern qualification in the auditors' report based on the assessment that the project's debt reserves would likely be utilized over a period of years and, absent changes in the relevant power and electricity markets, could need to renegotiate with its lenders in or around the year 2010.

d. Certain projects provide letters of credit ("LOCs") to PPA buyers for contingent project obligations. The Company's aggregate share of these LOCs was \$15,061 at December 31, 2005 (2004 – \$14,750) supported by the Company's revolving credit facility.

#### 14. INDEXED SWAP

A swap agreement (the "Indexed Swap") between the power utility and Onondaga has replaced the Project's original power purchase agreement. The Indexed Swap expires on June 30, 2008. The Indexed Swap is a financial instrument under which the utility company makes monthly payments to Onondaga based upon the differential between an indexed "contract price" and a market reference price for electricity. The indexed contract price fluctuates in relation to the market cost of natural gas and a prescribed index of inflation. The notional quantity of electricity for the purpose of these calculations is fixed for the full term of the Indexed Swap.

In May 2004, Onondaga contributed the Indexed Swap to a newly formed wholly owned special purpose subsidiary, Onondaga Power Swap Holdings, LLC ("OPSH"). Onondaga has guaranteed OPSH's obligations to the utility company under the Indexed Swap. Also in May 2004, OPSH entered into commodity hedges (the "Indexed Swap Hedge"), in order to lock in favourable gas, power and capacity pricing under the Indexed Swap. The hedges extend through June 30, 2008 and remove almost all commodity exposure from the Indexed Swap through its term.

Changes related to the Indexed Swap are summarized below:

	2005	2004
Fair value, as of December 31, 2004	\$ 99,591	\$ 101,468
Increase in fair value during the period	46,818	1,880
Settlements received	(38,495)	(3,757)
Fair value, as of December 31, 2005	\$ 107,914	\$ 99,591

Changes related to the Indexed Swap Hedge:

	2005	2004
Fair value, as of December 31, 2004	\$ (30,293)	\$ (29,566)
Increase in fair value during the period	(40,479)	(606)
Settlements received	12,225	(121)
Fair value, as of December 31, 2005	\$ (58,547)	\$ (30,293)

## 15. RELATED PARTY TRANSACTIONS

The Company has contracted with Atlantic Power Management, LLC (the “Manager”), a company owned by certain entities that form part of the non-controlling interest (note 10), for management services, including business planning, asset management, acquisitions, financial reporting and general management services. The Manager receives an annual management fee of \$300, cost reimbursements and an incentive fee equal to approximately 25% of cash distributions in excess of Cdn. \$1.00 per IPS and also on existing investors’ shares. In 2005, the Manager was paid \$2,989 (2004 – \$620).

The Manager subleases its office space from an existing investor under an agreement through 2014. The obligation under this sublease is \$130 per year in 2006 and 2007 and a total of \$933 for the period 2008 through 2014.

The Company has engaged Caithness Energy, a company affiliated with the non-controlling interest to provide operations and maintenance at four of the Projects and accounting, taxes and other administrative functions for 12 of the Projects. In 2005, Caithness Energy was paid \$2,750 (2004 – \$687).

## 16. FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair values of cash and cash equivalents, cash reserve fund, restricted cash, accounts receivable, dividends payable and accounts payable and accrued liabilities approximate carrying values due to the short-term nature of these balances.

The Indexed Swap and Hedge agreements (note 14) are recorded at their estimated fair value based on estimated future cash flows taking into account certain assumptions, including forecasts of future energy prices, inflation rates, discount rates and credit risk. Energy prices can be volatile and other assumptions can change from period to period. These factors can create significant fluctuations in the estimated fair value of this agreement.

The non-controlling interests are carried at estimated fair value based on the quoted market value of the IPSs.

The foreign exchange forward contracts are carried at estimated fair value based on quoted market value.

The fair value of long-term debt approximates its carrying value based on discounting of cash flows at current market rates.

The fair value of derivative financial instruments is as follows:

	2005	Fair value 2004	2005	Carrying value 2004
Indexed swap	\$ 107,914	\$ 99,591	\$ 107,914	\$ 99,591
Indexed swap hedge	(58,547)	(30,293)	(58,547)	(30,293)
Forward foreign currency contract (ii)	10,212	10,212	1,827	1,827
Interest rate swap assets (i), (ii)	-	1,666	-	-
Interest rate swap liabilities (i), (ii)	(6,171)	(3,195)	(6,171)	-
Natural gas swap assets (i), (ii)	3,183	2,626	-	-

i. represents the Company's proportionate share of joint venture investments.

ii. included in other assets on the balance sheet.

iii. included in other liabilities on the balance sheet.



For the year ended December 31, 2005, the Company has forward contracts to sell U.S. \$4,645 and receive Cdn. \$5,608 monthly through December 2009. The Company also has forward contracts to sell U.S. \$4,645 and receive Cdn. \$5,209 monthly during 2010. The average rate during the period to December 2009 is \$1.2055 and \$1.1225 during 2010.

#### 17. BASIC LOSS PER SHARE

Basic loss per share has been calculated using the weighted average number of units outstanding during the year of 38,659,055 (2004 – 34,727,273).

#### 18. SEGMENTED INFORMATION

The Company operates 14 Projects in the United States. It has one Project in Jamaica which is accounted for using the equity method.

The Company has one line of business being the sale of energy.

Revenue is earned primarily from contracts with large investor-owned utilities. One investment-grade utility contributed more than 10% of revenue (60% of revenue), whereas in the prior year, two investment-grade utilities contributed more than 10% of revenue (58% and 20% of revenue).



*Atlantic Power Corporation  
Directors (from left): John McNeil,  
Irving Gerstein, Ken Hartwick.*

# Corporate Information

## ATLANTIC POWER MANAGEMENT OFFICERS

**BARRY WELCH**  
President and  
Chief Executive Officer

**MARK BYSKOV**  
Chief Financial Officer and  
Corporate Secretary

**STEVE CHWIECKO**  
Managing Director  
Asset Management & Acquisitions

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## ATLANTIC POWER CORPORATION DIRECTORS

**IRVING GERSTEIN**  
Director and  
Chairman of the Board  
Atlantic Power Corporation  
Toronto, Ontario  
*Mr. Gerstein is a retired executive  
and is currently a Director of Medical  
Facilities Corporation, Economic  
Investment Trust Limited and Student  
Transportation of America.*

**KEN HARTWICK**  
Director and Chairman of the  
Audit Committee  
Atlantic Power Corporation  
Toronto, Ontario  
*Mr. Hartwick is currently the President  
of Ontario Energy Savings Corp.,  
which is a wholly owned subsidiary of,  
and provides administrative services  
to, Energy Savings Income Fund, an  
income trust traded on the TSX.*

**JOHN MCNEIL**  
Director  
Atlantic Power Corporation  
Toronto, Ontario  
*Mr. McNeil is President of Barker,  
Dunn & Rossi Canada, based in  
Toronto, Ontario, a subsidiary of  
Gestalt, LLC, an information tech-  
nology consulting firm.*

**ATLANTIC POWER  
HOLDINGS MANAGERS**  
(in addition to the three Atlantic  
Power Corporation Directors  
listed above and Barry Welch)

**DANIEL REVERS**  
Manager of Atlantic Holdings  
Boston, Massachusetts  
*Mr. Revers is co-founder and Managing  
Partner of ArcLight Capital Partners,  
Boston, Massachusetts.*

**ROBB TURNER**  
Manager of Atlantic Holdings  
New York, New York  
*Mr. Turner is co-founder  
and Senior Partner of ArcLight  
Capital Partners.*

**BILL WHITMAN**  
Manager of Atlantic Holdings  
Ridgewood, New Jersey  
*Mr. Whitman is currently the  
Senior Vice President of  
NW Financial Group, LLC, Jersey  
City, NJ, an investment bank  
specializing in municipal finance.*

## ATLANTIC POWER CORPORATION

**EXCHANGE LISTING**  
Ticker Symbol: ATP.UN  
IPS Issued and Outstanding:  
44,339,500  
Exchange: TSX

**INVESTOR RELATIONS**  
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**ANNUAL MEETING**  
Wednesday June 7, 2006, 10:00 a.m.  
Ontario Club  
30 Wellington Street West  
Commerce Court South, 5th Floor  
Toronto, Ontario

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