



## Management's Discussion and Analysis

For the years ended December 31, 2006 and 2005  
March 23, 2007

### Forward Looking Statements

Except for the historical and present factual information, certain statements contained in this Management Discussion and Analysis ("MD&A") constitutes "forward-looking statements" within the meaning of the *Securities Act (Ontario)*. These forward-looking statements, by their nature, are not guarantees of future performance and involve risks and uncertainties, which could cause actual results to differ materially from those anticipated in these forward-looking statements. We consider the assumptions on which these forward-looking statements are based to be reasonable, but caution the reader that assumptions regarding future events, many of which are beyond our control, may ultimately prove to be incorrect. Some of these risks and uncertainties are outlined in this MD&A.

Creststreet Kettles Hill Windpower LP (the "Partnership") disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required by law. These cautionary statements expressly qualify all forward-looking statements attributable to the Partnership.

The following is a discussion of the consolidated financial condition and results of operations of Creststreet Kettles Hill Windpower LP for the year ended December 31, 2006. It should be read in conjunction with the Partnership's audited consolidated financial statements for the same period. The Partnership prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") applied on a consistent basis with those used to prepare the prior year consolidated financial statements, except as noted in the consolidated financial statements. All dollar amounts in this MD&A are in Canadian dollars unless otherwise stated. Where we say "we," "us," or the "Partnership," we mean Creststreet Kettles Hill Windpower LP.

## Overview

In July 2005, the Partnership completed its initial public offering ("IPO") of limited partnership units, raising gross proceeds of \$40.00 million for investment in flow-through shares and subordinated notes of Kettles Hill Wind Energy Inc. ("Kettles Hill"). Kettles Hill is building and will operate a 63 megawatt ("MW") wind energy project composed of 35 interconnected Vestas V80 1.8MW turbines to generate electricity for sale to the Alberta power market. The Kettles Hill wind energy project is located near Pincher Creek, Alberta, approximately 200 kilometres south of Calgary and approximately 20 kilometres east of the Rocky Mountains. The site is adjacent to a 138kV transmission line.

We estimate that the capital cost to construct all 35 turbines and related infrastructure will be approximately \$120.9 million which represents an increase of 2% over the previous forecast of the costs. These increases arose principally due to higher construction costs in the over-heated Alberta market place, and constructing during the windy winter season due to delivery delays of turbines by the manufacturer. The wind energy project is being financed through a combination of the proceeds from the Partnership's IPO, investments by various Creststreet entities and debt facilities provided by a major Canadian financial institution. Please see the liquidity section of this MD&A for details on the financing of the project.

In March 2006, Kettles Hill completed the construction and commissioning of the five Canadian Renewable and Conservation Expense (the "CRCE Phase") test turbines at the Kettles Hill facility. It also completed construction and commissioning of the related infrastructure including access roads, interconnection transmission facilities, substation infrastructure, collection system infrastructure and a remote monitoring system. Construction of the CRCE Phase was delayed approximately three months as a result of equipment delivery delays by Vestas-Canadian Wind Technology, Inc. ("Vestas"), the turbine supplier. The 120-day test period required to qualify expenses for test turbines for CRCE tax treatment was completed on July 28, 2006. All electricity produced by these CRCE Phase turbines was sold into the Alberta power market at the prevailing market rates, (see the Revenue discussion below).

With the CRCE test period having been completed, work to install and commission the remaining 30 wind turbines for the second phase of the project (the "Infill Construction Phase") is underway. Completion of this phase of the project was delayed another three months as Vestas advised the Manager of additional equipment delivery delays, with final deliveries made in December 2006. In the third quarter of 2006, Kettles Hill received liquidated damages from Vestas as a result of the delays in equipment delivery in the amount of \$3.50 million. The project was also delayed by the requirement to change to a more traditional foundation design, which takes longer to build, due to complex soil conditions at the site. On March 18, 2007, the erection crane suffered a malfunction. The manager expects this crane malfunction will result in a delay of completion of one month. At this time any cost increases resulting from this are expected to be within the project's existing contingency financing. Based on its current schedule, the Manager expects that the project will be completed during May 2007. This would result in an aggregate eight months delay to the project schedule, due to both the Vestas delays, foundation construction delays and the crane malfunction delay.

High activity levels in the Alberta construction market continued to increase construction costs in 2006, resulting in incurred and expected cost overruns. These cost overruns were previously anticipated to be substantially offset by foundation design changes and savings on the cost of turbines from the depreciation of the Euro relative to the Canadian dollar. The currency savings have been realized as anticipated. However, upon further investigation into the foundation design changes, it was deemed the original design was inappropriate for the soil conditions at site. The combined impact of the Alberta construction market, delays and not realizing the design change savings has led to a 4% increase in the construction costs to this point.

The ground and foundation work for the Infill Construction Phase has been completed in the first quarter of 2007. The erection of the towers and turbines started in the fourth quarter of 2006 and is anticipated to be completed in May 2007. The table below highlights the status of all 35 turbines:

<u>Status</u>	<u>Number</u>
Turbines completed, operating and producing power <sup>(1)</sup>	16
Turbines erected and awaiting commissioning	4
Foundations complete with towers and turbines under installation	15
<b>Total:</b>	<b>35</b>

(1) Includes five turbines completed in first quarter, 2006.

All permits and authorizations required for the CRCE Phase and the Infill Construction Phase of the Kettles Hill facility have been obtained by Kettles Hill and are in good standing, other than those permits and authorizations that are not yet required, but which are expected to be obtained prior to or upon the completion of the Infill Construction Phase.

During the twelve months of 2006, \$55.76 million (2005 - \$28.52 million) was spent on the project.

## Results of Operations

### > Revenue

For the year ended December 31, 2006, the Partnership generated electrical revenue of \$1.48 million (2005 - \$nil) from the delivery of 21.8 gigawatt hours ("GWh") of electricity generated by the five CRCE turbines that began commercial operations in March 2006. This electricity was sold into the Alberta spot market at the prevailing Alberta Power Pool prices at the time of delivery. During 2006 the Partnership realized electrical pricing on average of \$68.01 per megawatt hour ("MWh").

### > Operating Costs

For the year ended December 31, 2006, the Partnership incurred operating costs of \$0.32 million (2005 - \$nil) and recorded an operating margin of 78% of revenue. The expenses related to the operation of the project are primarily fixed costs such as warranty and maintenance fees, leases, energy charges and transmission charges. Other operating costs for

the year included management fees of \$0.79 million and administrative costs of \$0.45 million (2005 - \$0.60 million and \$0.17 million respectively).

#### **> Amortization**

The costs of construction in progress related to the CRCE Phase were reclassified to plant and equipment in the first quarter of 2006 when this phase of the project entered commercial operations. Amortization of these costs began at that time. The total amortization for the year was \$1.30 million.

We also began amortizing deferred charges and pre-operating costs upon substantial completion of the CRCE Phase and recorded amortization of deferred financing charges and pre-operating costs of \$0.54 million for the year ended December 31, 2006.

#### **> Interest and gains and losses on derivatives**

Interest expense recorded in the year ended December 31, 2006 totaled \$0.58 million (2005 - \$nil) which includes the interest incurred on the \$900,000 subordinated promissory note investment made by Creststreet Windpower Development LP ("CWDLP"), interest incurred on \$6.50 million of the \$32.00 million subordinated promissory note investment made by Creststreet Power & Income Fund LP ("CPIF"). These funds were used by the Partnership to help fund the construction of the CRCE Phase of the wind energy project. Interest costs on the funding for the Infill Construction Phase have been capitalized to Construction in Progress and amounts to \$1.21 million (2005 - \$nil) for the year ended December 31, 2006.

Kettles Hill had previously entered into option agreements to purchase Euros (EUR), which were used to reduce foreign exchange rate exposure on future purchases of wind turbines and were not entered into for trading or speculative purposes. These options did not qualify for hedge accounting and, as such, were recorded at their fair value on the consolidated balance sheet. The total cost of purchasing these options of \$0.89 million was capitalized to pre-operating cost. On July 31, 2006 Kettles exercised its last option agreement to purchase EUR 7.00 million at an exercise price of C\$1.4170 per EUR for which it paid consideration of \$0.14 million; settlement proceeds of \$0.16 million were received. Subsequently this amount was recorded as foreign exchange gain in the consolidated statement of loss and deficit.

Four option agreements expired unexercised during the second quarter of 2006 as follows: (i) EUR 5.0 million at an exercise price of C\$1.5100, expired April 7, 2006; (ii) EUR 10.0 million at an exercise price of C\$1.5100, expired April 28, 2006; (iii) EUR 5.0 million at an exercise price of C\$1.5100 per EUR, expired June 15, 2006, (iv) EUR 5.0 million at an exercise price of C\$1.5100 per EUR, expired June 30, 2006.

For the year ended December 31, 2006, a gain of \$0.08 million (2005 - \$nil) was realized on the foreign exchange options.

## > Taxes

The Partnership's results for the second quarter of 2006 were positively impacted by a reduction in the enacted Federal corporate income tax rate. This resulted in a non-cash reduction in future taxes of \$0.75 million. For the year end December 31, 2006, the Partnership reported a future income tax recovery of \$1.51 million (2005 - \$nil).

### Quarterly Financial Information

(In thousands, except per unit data)

	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Total
Revenue	\$ -	\$ -	\$34	\$62	\$96
Net loss	\$ -	\$ -	\$(484)	\$(190)	\$(674)
Net loss per unit	\$ -	\$ -	\$(0.14)	\$(0.05)	\$(0.36)

	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Total
Revenue	\$69	\$305	\$363	\$940	\$1,677
Net earnings / (loss)	\$(209)	\$427	\$(459)	\$(507)	\$(748)
Net earnings / (loss) per unit	\$(0.05)	\$0.11	\$(0.12)	\$(0.13)	\$(0.19)

The CRCE Phase turbines at Kettles Hill began commercial production of electricity and began generating revenue and incurring operating expenses in March 2006. The second, third and fourth quarters of 2006 reflect full quarters of revenue and expenses from the initial five turbines. Windpower electrical generation experiences seasonality with peak seasons occurring in the first and fourth quarters and the low season in the third quarter. The difference in net income in the second quarter compared to other quarters in 2006 is because of the enactment of lower federal income tax rates in the second quarter which resulted in a large future income tax recovery as discussed in the Taxes section above. The first quarter of 2006 reflected one month of revenue and operating expenses from the initial five turbines.

As Kettles Hill did not begin commercial production of electricity until the first quarter of 2006, all revenue earned in 2005 was interest income. During the third quarter of 2005, Kettles Hill earned \$34,000 in interest income on short-term investments and paid management fees of \$471,000 including a one-time fee of \$342,000 upon completion of the IPO.

During the fourth quarter of 2005, Kettles Hill earned \$62,000 in interest income on short term investments and paid management fees of \$128,000.

### Fourth Quarter

Fourth quarter electricity based revenues were \$0.82 million compared to \$0.32 million in the third quarter of 2006. The primary reasons for the increase were the seasonal increase in wind speeds along with higher realized spot prices. In the fourth quarter the Partnership delivered 9.5 GWh of electricity generated by the five CRCE turbines compared to 4.5 GWh produced in the third quarter and realized an average price of \$85.69 per MWh in the fourth quarter compared to \$71.65 per MWh in the third quarter.

Operating costs for the fourth quarter were \$0.12 million compared to \$0.09 million in the third quarter. The increase relates to an increase in rent and AESO charges which are both based on a percentage of revenue.

Management fees in the fourth quarter were \$0.35 million compared to \$0.16 million in the third quarter. In accordance with the management contract the Manager began to charge its related overhead costs to Kettles Hill.

Fourth quarter interest expense was \$0.18 million compared to \$0.20 million in the third quarter. Interest income was \$0.12 million in the fourth quarter compared to \$0.04 million in the third quarter due to increase in cash balance in fourth quarter.

The net loss in the fourth quarter was \$0.51 million compared to a net loss of \$0.46 million in the third quarter.

In the fourth quarter of 2005 commercial operations had not started, the net loss reflected management fees and general administrative expenses.

## Financial Condition

### > Liquidity

The estimated capital cost of the Kettles Hill project is \$120.9 million including approximately an 11% contingency on the variable costs to complete. We anticipate that the Kettles Hill project will be financed as follows:

Investment by Creststreet Windpower Development LP I and II	\$4.5 million
Proceeds of Kettles Hill Windpower LP IPO (net of fees associated with offering and reserves)	34.5 million
Subordinated notes funded by Creststreet Power & Income Fund LP	34.0 million
Senior debt facility (provided by a major Canadian financial institution)	42.5 million
Subordinated debt facility (provided by a major Canadian financial institution)	5.0 million
Net cash flow from operations during construction	2.3 million
<b>Total Financing</b>	<b>\$122.8 million</b>

On December 19, 2005, Kettles Hill announced a commitment by CPIF to invest up to \$31.00 million in subordinated notes to complete the financing requirements to fund the completion of the project and to fund any working capital requirements. Additional investments by CPIF of up to \$4.90 million in notes to Kettles Hill were approved at a special meeting of CPIF Unitholders on September 6, 2006. As at December 31, 2006, \$32.00 million was advanced by CPIF. The terms of these subordinated notes are described in further in the Related Party Section of the MD&A. Subsequent to the year-end, a further \$2.00 million was advanced by CPIF.

On December 19, 2005, Kettles Hill also announced the closing of a construction loan facility with a major Canadian financial institution totaling \$42.50 million to finance its Infill Construction Phase of which \$20.00 million was advanced during the third quarter. The terms of this loan are described in Note 10 to the consolidated financial statements for December 31, 2006. On

August 4, 2006, \$8.75 million of Tranche A became subject to Kettles Hill receiving confirmation that it will receive contributions from the Government of Canada's Wind Power Production Incentive ("WPPI") program or an equivalent program. If confirmation of the contribution is received, this \$8.75 million advance of Tranche A will use an interest rate mechanism and credit spread representative of a senior secured credit facility. If the WPPI contribution is received this advance of Tranche A will not be required to amortize consistent with the rest of the loan. If the WPPI contribution is not received this advance's interest rate will then be calculated using a Government of Canada long bond yield plus a credit spread that is more representative of a subordinated debt facility. As well, if the WPPI contribution is not received, this portion of the loan will require principal payments of \$2.00 million per year until March 31, 2009.

As at December 31, 2006, the average effective interest rate for the \$42.50 million construction loan facility, if fully drawn and if Kettles Hill receives the WPPI contribution would be 6.01%. If Kettles Hill is not eligible for WPPI or if the program ceases to exist, the effective interest rate on this loan will be 7.16%.

During the fourth quarter of 2006, Kettles Hill negotiated a \$5.00 million subordinated debt facility with a major Canadian financial institution to provide additional liquidity to finance a portion of the cost increases and to also provide additional liquidity in the event that there may be potential cost increases, during the construction of the Infill Phase. This facility, which matures on December 31, 2008, bears interest at 12% per annum and requires excess cash flow as defined by the agreement will be used to partially repay outstanding balances in excess of \$2.00 million prior to December 31, 2008. The other terms and conditions are standard for this type of facility.

Cash held in escrow increased to \$13.06 million at December 31, 2006, from \$2.90 million at December 31, 2005, as the second advance of \$13.75 million on the credit facility was placed into escrow along with \$1.00 million of the CPIF debt, and \$1.69 million was released and used to fund construction activities. Funds advanced to Kettles Hill through its credit facility are placed in escrow and may only be accessed for construction related expenses upon acceptance of the lender.

#### > Contractual Obligations

(In \$ millions)	Total	Due less than 1 year	Due 2 to 3 years	Due 4 to 5 years	Due after 5 years
Long-term debt obligations	\$66.65	\$ -	\$45.75	\$ -	\$ 20.90
WMS agreement	5.55	0.88	2.27	2.28	0.12
Land lease (see below)					
Other construction agreements (see below)					
<b>Total obligations</b>	<b>\$72.20</b>	<b>\$0.88</b>	<b>\$48.02</b>	<b>\$2.28</b>	<b>\$21.02</b>

Kettles Hill has entered into four lease agreements with terms of each lease being 20 years with provisions for renewal of each lease for two additional 20 year terms. The annual rent payable under each lease agreement is 2.5% of electricity revenue.

Kettles Hill entered into a Warranty, Maintenance and Service Agreements (“WMS Agreement”) with Vestas – Canadian Wind Technology (“Vestas”), which provides for certain warranties in connection with the wind turbines installed at the wind energy project, and ongoing service and maintenance obligations in connection with the turbines. The WMS Agreement includes a facility-wide warranty, which commences only upon substantial completion of the Infill Phase and is related to power curve performance and availability of the facility. In the event that the facility fails to perform as warranted, the WMS Agreement entitles Kettles Hill to liquidated damages to offset any lost revenue. The WMS Agreement is for a 5-year period commencing at the date that the turbines come into service at a cost of \$32,500 per turbine per year. As at December 31, 2006, the total remaining commitment to Vestas under the WMS Agreement was \$5.55 million.

Kettles Hill has entered into an Engineering, Procurement and Construction Services (“EPCS”) Agreement with Hatch Optima Ltd. to design all non-turbine related aspects of the project, purchase any non-turbine equipment and manage the construction. Costs are incurred on a time and material basis.

In 2005, Kettles Hill entered into an agreement with Plava Ventures Corp. to pay success fees of \$50,000 upon the closing of CRCE Phase construction financing which occurred in 2006 and another \$50,000 upon the completion of the Infill Phase construction.

In April 2006, Kettles Hill signed a contract for the sale of 30 GWh of renewable energy certificates to Baseline Emissions Management Inc. (“Baseline”). The revenue generated from this contract will be recognized on an annual basis within forty-five days after the end of each calendar year, upon an executed transfer of title of the renewable energy certificates by Kettles Hill to Baseline. A total of \$22,500 was recorded as deferred revenue at December 31, 2006 for a portion of the 2006 production. Additionally in June 2006, Kettles Hill entered into an agreement with the federal government for the sale of 46,000 tonnes of emissions reductions from 2007 production at a price of \$7.97 per tonne of CO<sub>2</sub> equivalent.

### **> Business Acquisition**

In 2005, the Partnership acquired 17.77 million Class A shares of Kettles Hill for \$23.81 million obtaining an 83.15% interest in the assets of Kettles Hill.

### **> Related Party Transactions**

Kettles Hill has entered a Financial Administration Agreement (“FAA”) dated May 31, 2005 with Creststreet Capital Corporation (“CCC”), a related party with common management, to maintain the minute books and records of the Company and to provide it with other general accounting and cash management services in return for the reimbursement of expenses and a fee of \$1,500 per month in the first year of the agreement, and thereafter a fee of \$7,500 per month

for the remaining term of four years, subject to adjustments and inflation. The total incurred for the year ended December 31, 2006 was \$18,000 (2005 - \$9,000).

Kettles Hill has entered into a Consulting Service Agreement (“CSA”) with a shareholder, Benign Energy Canada Inc. (“BECI”). The CSA has a term ending on the date of substantial completion of the Infill Phase. BECI will assist with supervision of the construction and administration of the EPCS and Turbine Supply Agreement (“TSA”). BECI will be paid:

- i. A consulting fee of \$1.00 million, of which \$320,000 payable upon substantial completion of CRCE Phase which occurred in 2006, \$320,000 on substantial completion of Infill Phase, and equal monthly installments of \$30,000 each beginning in August 2005 and ended 12 months later.
- ii. An incentive fee equal to 25% of the remaining unused contingency, payable upon substantial completion of CRCE Phase and Infill Phase. The maximum fee payable to BECI under the Consulting Service Agreement is \$1.87 million. In addition to this, BECI will be reimbursed for any out-of-pocket expenses incurred in providing the services.

Kettles Hill has entered into a Management Services Agreement (“MSA”) with BECI to assist in the day-to-day operations of the facility which has an initial term of five years and will be renewed automatically unless BECI provides one year’s prior written notice of its intention not to renew. BECI will be paid a monthly base fee of \$6,666 from the substantial completion of CRCE Phase until substantial completion of the Infill Phase, following which the monthly base fee shall be increased to \$16,666, indexed to inflation. BECI will be reimbursed for any out-of-pocket expenses.

For the year ended December 31, 2006, fees charged by BECI in accordance with the CSA and MSA, including reimbursement for out-of-pocket expenses amounted to \$617,894 (2005 - \$200,210).

On October 29, 2004, Kettles Hill issued 1,225 non-voting preferred shares to BECI for \$1.23 million with a cumulative dividend of 7% per annum. On July 11, 2005, the preferred shares were redeemed at the price of \$1 per share for \$1.23 million and \$47,456 of cumulative dividends were paid at the same time.

BECI and CS Capital Partners Ltd. own Class B shares of Kettles Hill. Holders of the Class B shares will be entitled to 5% of electricity revenue (excluding WPPI).

In 2005, Kettles Hill entered into a subordinated note with Creststreet Windpower Development LP (“CWDLP”), a related party with common management for \$900,000 to finance pre-development costs due on July 31, 2025. Interest is charged at a rate of 10% per annum. The note is redeemable at any time after July 31, 2015 by Kettles Hill at par plus accrued interest. If there is a change in ownership the debt is redeemable at 105% of par plus accrued interest, unless waived in writing by CWDLP. Interest payments are deferred until the earlier of December 31, 2006 or completion of the Infill Construction Phase whereby greater than 30 turbines are commissioned. As at December 31, 2006, the Partnership had incurred \$90,000 of interest during the year, of which \$14,548 (2005 – \$64,473) was capitalized during the

construction period and \$75,452 (2005 - \$nil) expensed to the statement of loss and deficit once commercial operations began for the CRCE Phase.

On December 19, 2005, CPIF, a related party with common management, committed to invest in subordinated notes of Kettles Hill (the "CPIF Notes") to help complete the funding requirements of the project. CPIF committed to invest up to \$31.00 million in subordinated notes. By the end of the third quarter of 2006 CPIF had invested the full \$31.00 million commitment. Additional investments by CPIF of up to \$4.90 million in notes to Kettles Hill were approved at a special meeting of CPIF Unitholders on September 6, 2006. In the fourth quarter of 2006, CPIF invested an additional \$1.00 million, bringing its total investment to \$32.00 million by the end of 2006. On November 29, 2006 CPIF announced an additional \$2.00 million will be invested in Kettles Hill by the end of the first quarter of 2007 subject to certain conditions, of which the full \$2.00 million has been invested subsequent to December 31, 2006.

During the third quarter of 2006, the terms of the \$6.50 million CPIF Notes previously outstanding were amended to match the terms of the \$24.50 million of CPIF Notes that were issued during the third quarter. The CPIF Notes terms now include an interest rate of 9.25% per annum until October 31, 2009 and thereafter at a rate of 10.5%. Interest on the notes will accrue monthly. Previously the interest rate was 8.25% per annum until October 31, 2009 and then 9.25% thereafter. Interest payments are deferred until the earlier of September 30, 2007 or 60 days after completion of the Infill Phase. The conversion option has been replaced by a redemption feature that requires the Partnership to purchase these notes at 110% of par plus 50% of the amount, if any, that the fair market value of each Class A share of Kettles Hill, realized upon a change of control, exceeds \$1.87 per Class A share multiplied by the principal amount of the Kettles Hill subordinated notes held by CPIF divided by \$1.70 if Kettles Hill is purchased by a third party other than CPIF. If the Partnership is acquired by CPIF the maturity of the subordinated notes extends to October 31, 2026. As a result of the removal of the conversion feature of the subordinated note, \$76,471 has been reclassified from Equity component of subordinated note payable to Contributed Surplus.

The payment of the principal of, and interest on, all the subordinated notes is fully subordinated to the credit facility. The payment of interest on the subordinated notes will rank in priority to the payment of interest only on other subordinated indebtedness and the payment of principal on the subordinated notes will rank *pari passu* with the payment of principal on other subordinated indebtedness of Kettles Hill.

As at December 31, 2006, the Partnership has incurred \$1.32 million (2005 - \$nil) of interest, of which \$23,733 (2005 - \$nil) was capitalized to Pre-operating costs during the CRCE Phase, \$817,192 (2005 - \$nil) was capitalized to Construction-in-progress during the Infill Phase and \$480,582 (2005 - \$nil) interest expensed to the income statement. A financing fee of \$50,000 (2005 - \$nil) was charged by CPIF for the issuance of CPIF Notes over the original \$31.00 million investment, this was capitalized to construction in progress.

The current amounts due (to) from related parties as at December 31, 2006 are as follows:

December 31	2006	2005
CCC	\$ (320)	\$ (43)
CWDLP	(187)	(104)
BECI	(51)	-
CHL	-	-
CPIF	(1,322)	-
Dokie Wind Energy Inc.	5	-
Benchland Wind Power Corp.	11	-
	<b>\$ (1,864)</b>	<b>\$ (147)</b>

The amounts incurred from (to) related parties are as follow:

December 31	2006	2005
BECI	<b>\$(618)</b>	\$(1,472)
Manager	(511)	(599)
CHL	(109)	(64)
CCC	(265)	(9)
Dokie Wind Energy Inc.	5	-
Benchland Wind Power Corp.	12	-
CWDLP	(83)	(110)
CPIF	(1,372)	-
	<b>\$(2,941)</b>	<b>\$(2,254)</b>

### Change in Partners' Capital

Partners' capital decreased to \$28.69 million at December 31, 2006, from \$36.62 million at December 31, 2005, as a result of renunciations of resource expenditure deductions for income tax purposes.

### Selected Annual Information

	2006	2005	2004
Revenue	<b>\$1.68</b>	\$ 0.10	\$ -
Loss for the year	<b>(0.75)</b>	(0.67)	-
Loss per unit	<b>(0.19)</b>	(0.36)	-
Total assets	<b>113.16</b>	48.26	-
Long-term liabilities	<b>75.14</b>	2.05	-

## Critical Accounting Estimates

Amortization of plant and equipment is based on a useful life of 20 years which is in accordance with the estimates from the turbine manufacturer.

The Partnership used a 2% inflation rate in calculating its asset retirement obligation (“ARO”). This inflation rate is in line with the target rate which is established by the Bank of Canada. The Partnership then discounted the ARO using a credit-adjusted risk-free rate of 10.72%. At December 31, 2006, the Partnership’s undiscounted ARO was \$1.31 million (2005 - \$nil). ARO are primarily associated with certain closure, reclamation and restoration costs related to retirement of the wind energy facilities. Most of these obligations are not expected to be paid for 20 years and will be funded from general company resources at that time. Actual obligations could differ from these estimates. Revisions to the Partnership’s asset retirement obligation will be made prospectively if new information is available.

## Change in Accounting Policies Recent Accounting Pronouncements

The CICA has issued the following new and revised accounting standards:

**Section 3855, Financial Instruments – Recognition and Measurement**, effective for fiscal years beginning on or after October 1, 2006. This section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value. The impact of re-measuring our financial assets and liabilities at fair value will be recognized in opening deficit and opening accumulated other comprehensive income as appropriate. The impact of the adoption of this new section on the consolidated financial statements is not expected to be material.

**Section 1530, Comprehensive Income**, effective for fiscal years beginning on or after October 1, 2006. It describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in Partners’ capital, which results from transactions other than those resulting from investments by Limited Partners and distributions to Limited Partners. These transactions and events include unrealized gains and losses resulting from changes in fair value of certain financial instruments. The impact of the adoption of this new section on the consolidated financial statements is not expected to be material.

**Section 3865, Hedges**, effective for fiscal years beginning on or after October 1, 2006. The recommendations expand the guidelines outlined in Accounting Guideline 13 (“AcG-13”), Hedging Relationships. This Section describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenues and expenses from the derivative financial instruments in the same period as for those related to the hedged item. The adoption of the standard will have no impact on the consolidated financial statements.

**Revised Section 1506, Accounting Changes**, effective for fiscal years beginning on or after January 1, 2007. This provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information. The Partnership does not expect application of this revised standard to have a material impact on its consolidated financial statements.

These standards will be effective for the Partnership as of January 1, 2007 and will be adopted retroactively, without restatement.

**Section 1535, Capital Disclosures**, effective for fiscal years beginning on or after October 1, 2007 which will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Partnership is assessing the impact on its consolidated financial statements.

## Outlook

The project is in the midst of construction of the Infill Phase and activities remain focused on managing costs and logistics. Shortages of supplies and labour continue to plague all activities in Alberta and adjoining provinces, including our project. While costs reflect the Manager's best estimate of Costs to Complete, Unitholders are cautioned that the project remains exposed to cost increases associated with the Alberta Market and winter construction.

On March 5, 2007, the independent directors (the "Independent Committee") of the General Partner of Creststreet Kettles Hill Windpower LP announced that they have appointed an independent advisor to assist the Independent Committee on its mandate to provide liquidity to the Unitholders of the Partnership within six months of the completion of the windpower facility, as outlined in the Partnership's initial public offering prospectus. Blair Franklin Capital Partners Inc. will serve as the independent advisor. On March 18, 2007, the erection crane suffered a malfunction. The manager expects this crane malfunction will result in a delay of completion of one month. At this time any cost increases resulting from this are expected to be within the project's existing contingency financing. Completion of the windpower facility is scheduled for the end of May 2007, at which time it is expected that the process to provide liquidity would commence.

Year-to-date 2007 power prices in Alberta have averaged over \$65.59 per MWh as at March 22, 2007. The Manager views the independent energy forecast provided in the Partnership's initial public offering prospectus as conservative in light of the strengthening of forward market power prices to above \$70.00 per MWh. According to Alberta Watt Exchange Ltd., the forward settlement price of Alberta baseload power as at March 15, averaged \$59.83 per MWh for the second quarter of 2007 and \$86.75 per MWh for the third quarter of 2007 and \$75.32 per MWh for the remainder of the calendar year.

## **Disclosure Controls and Procedures and Internal Controls over Financial Reporting**

In order to ensure that information with regard to reports filed or submitted under securities legislation present fairly in all material respects the financial information of the Partnership management, including the President and Chief Executive Officer (“CEO”) and the Vice President, Finance and Chief Financial Officer (“CFO”) are responsible for establishing and maintaining disclosure controls and procedures as well as internal control over financial reporting.

### **Disclosure Controls and Procedures**

Disclosure controls and procedures are designed and implemented by, or under the supervision of the Partnership’s CEO and CFO to ensure that material information relating to the Partnership is communicated to them by others in the organizations as it becomes known and is appropriately disclosed as required under the continuous disclosure requirements of securities legislation. In essence, these types of controls are related to the quality and timeliness of financial and non-financial information in securities filings. An evaluation of the effectiveness of the design and operation of the Partnership’s disclosure controls and procedures was conducted as at December 31, 2006, by and under the supervision of the Manager, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that the Partnership’s disclosure controls and procedures, as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers’ Annual and Interim Filings, are effective to ensure that information required to be disclosed in reports that we file or submit under Canadian securities legislation is recorded, processed, summarized and reported within the time periods specified in those rules and forms.

### **Internal Controls over Financial Reporting**

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of our financial reporting and compliance with Canadian generally accepted accounting principles in our consolidated financial statements.

During fiscal 2006, the Partnership’s Manager documented and assessed the design of internal controls over financial reporting for its operating and accounting processes. Similar to the evaluation of disclosure controls and procedures referred to above, the design of internal controls over financial reporting was evaluated as defined in Multilateral Instrument 52-109. During the course of this evaluation certain weaknesses in our controls were identified. Due to the limited number of staff at the Partnership’s Manager, there is an inherent weakness in the system of internal controls due to our inability to achieve appropriate segregation of duties as it is not economically feasible to have a sufficient number of staff working for the Partnership. The limited number of staff may also result in not identifying weaknesses with respect to accounting for complex and non-routine accounting transactions as the Manager does not have a sufficient number of finance personnel with technical accounting knowledge to address all complex and non-routine accounting matters that may arise. As a result of these weaknesses there is no guarantee that a material misstatement would not be prevented or detected. These items have been classified as material weaknesses. Management and Board review are utilized to mitigate the risk of material misstatement in financial reporting to ensure internal controls remain

effective and we will be able to remediate these weaknesses by expanding the number of individuals in our financial reporting area as the Manager grows.

The Manager has evaluated whether there were changes in our internal controls over financial reporting during the year ended December 31, 2006, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. No such changes were identified through management's evaluation or any other means.

### > Comparison of Financial Projection to Actual Results

On June 30, 2005 the Partnership filed its' initial public offering prospectus which included a financial projection that reflected the anticipated completion dates for both the CRCE Turbine Phase of December 31, 2005 and August 31, 2006 for the Infill Construction Phase. Due to the equipment delivery delays and other construction delays discussed previously in this MD&A these anticipated completion dates were not met, and consequently the actual results for 2006 were below the projection. The CRCE phase was completed in March 2006, while the Infill Construction Phase is anticipated to be completed no earlier than May 2007. The table below compares the 2006 actual results to the projection:

(in \$000's)	Actual Results Year – Ended December 31, 2006	IPO Projection Year – Ended December 31, 2006
Revenues:		
Electricity (including WPPI)	\$1,677	\$6,856
Expenses:		
Operating expenses	1,111	1,483
General and administrative expenses	448	818
Income before amortization, interest expense, non-controlling interest, future income taxes	118	4,555
Amortization	1,902	2,845
Interest expense	544	1,771
Loss before non-controlling interest, future income taxes	(2,328)	(61)
Non-controlling interest	68	(146)
Future income tax recovery	1,512	146
Loss for the year	\$(748)	\$(61)

## Risk and Uncertainties

### > WPPI Risk

The 2005 federal budget provided \$200 million over five years and a total of \$920 million over 15 years to expand the WPPI program from 1,000 MW to 4,000 MW. Under the program, projects commissioned from April 1, 2002 to March 31, 2003 were eligible to receive an incentive payment of \$0.012 per/kWh of production for the first 10 years of operation. Projects commissioned after March 31, 2003 and on or before March 31, 2006 were eligible to receive an incentive payment of \$0.01 per/kWh of production for the first 10 years of operation, and projects commissioned after March 31, 2006 and on or before March 31, 2007 are eligible to receive an incentive payment of \$0.008 per/kWh of production for the first 10 years of operation. The eligible production per project is determined by Natural Resources Canada. In October 2005, Natural Resources Canada issued a discussion paper on the possible expansion of WPPI. One of the proposed changes for any awards is to limit the incentive for any one project to a production level based upon a 30% capacity utilization factor. However, no further funding is available under the original WPPI program so that, absent expansion of the WPPI program, no WPPI payments would be available to Kettles Hill.

Announced on January 19, 2007, the ecoEnergy Renewable Initiative seeks to invest \$1.5 billion to boost Canada's renewable energy supply. The 10 year program will fund approximately 4,000 MW of new eligible renewable power projects over the next 4 years (between April 1, 2007 and March 31, 2011). The program is to be administered by NRCAN and is expected to support roughly 3,000 MW of wind power and 1,000 MW of other renewable sources including low impact hydro, biomass, solar, geothermal, and ocean energy. The program is expected to contribute 1 cent per kWh of production over 10 years for eligible projects. Details of the program are outlined in an NRCAN discussion paper dated January 2007. Program administration details are expected to be finalized by April 1, 2007. Among the details under consideration is a maximum capacity factor for windpower of 34%. Once the program details are finalized Kettle Hills will apply but currently Kettles Hill has not qualified under this program.

### > Construction Risk

Construction of the wind energy projects is dependent on turbines being installed and tested. Until the Infill Phase is complete there is a risk that the completion date for the turbines could be delayed or that material cost overruns could be incurred, with any construction occurring during the windy winter season.

### > Electrical Pricing Risk

The Partnership's revenue has exposure to movements in market price of electricity, as sales to the Alberta power market are likely to be made at prevailing market prices. The market price of electricity is sensitive to cyclical changes in demand and capacity supply, and in the economy, as well as to regulatory trends and developments impacting electricity market rules and pricing, transmission development and investment within Alberta and to power markets in

other jurisdictions via interconnects and other external factors outside of the controls of the Partnership and the Manager. Accordingly, the revenue, income and cash of the Partnership may be volatile and adversely affect the value of and distribution from Units.

#### **> Wind Risk**

The wind speeds at the Kettles Hill site will vary, weather patterns could change or the historical data could prove not to accurately reflect the strength and consistency of the wind in the future and have an adverse impact on cash distributions.

#### **> Regulatory Environment Risk**

The profitability of Kettles Hill will be in part dependent upon the continuation of a favourable regulatory climate with respect to the continuing operations and the future growth and development of the independent power industry. Government regulations and incentives currently have a favourable impact on the building of wind power facilities but should they be modified, cash distributions could be adversely affected.

#### **> Counter Party Risk**

The operations of the Partnership and Kettles Hill are highly dependent upon parties to certain agreements fulfilling their contractual obligations, especially the turbine supplier, Alberta Electric System Operator, and BECI. An inability or failure by any such party to meet its contractual commitments may adversely affect cash distributions.

Vestas is the only supplier of wind turbines to Kettles Hill and accordingly, the Partnership is dependent upon Vestas fulfilling its contractual obligations to them.

The occurrence of a significant event, which disrupts the ability of Kettles Hill to produce or sell power for an extended period, including events which preclude existing customers from purchasing power, could have a material adverse effect on the Partnership.

#### **> Insurance Risk**

While the General Partner believes that the insurance coverage for the facility will address material insurable risks, provide coverage that is similar to what would be maintained by a prudent owner/operator of similar facilities, and be subject to deductibles, limits, and exclusions which are customary or reasonable given the cost of procuring insurance, current operating conditions and insurance market conditions, there can be no assurance that insurance coverage for Kettles Hill will be sufficient, will address all material insurable risks and will continue to be offered on an economically feasible basis.

#### **> Tax Risk**

There can be no assurance that the income tax laws in the various jurisdictions of Canada, or the interpretation thereof, will not be changed in a manner which will fundamentally alter the tax consequences to Limited Partners of holding or disposing of units.

In any fiscal year of the Partnership, the possibility exists that Limited Partners will receive allocations of income and capital gains without receiving cash distributions from the Partnership in such year sufficient to satisfy their tax liability with respect to such allocations.

On October 31, 2006, the Minister of Finance (Canada) announced new tax proposals concerning the taxation of publicly traded income trust and other flow-through entities. The October 31, 2006 proposal was followed by the release of draft legislation by the Department of Finance on December 21, 2006. The 2006 Proposed Amendments, in enacted as currently drafted, will not subject the Partnership to trust level taxation as of January 1, 2011. In addition, the taxable distributions received by investors from the Partnership, would not be treated as taxable dividends. If the Partnership became public these rules would apply.

#### **> Partners' Risk**

Limited Partners remain liable to return to the Partnership such part of any amount distributed to them as may be necessary to restore the capital of the Partnership to the amount existing before such distribution if, as a result of any such distribution, the capital of the Partnership is reduced and the Partnership is unable to pay its debts as they become due.

There is no market through which the units may be sold. Following completion of the Infill Construction Phase, an Independent Committee will solicit, as and when appropriate, opportunities to provide Limited Partners with liquidity for their units.

#### **> Re-financing Risk**

A significant portion of the principal amount of the Kettles Hill Senior Debt Facility, if fully advanced, will mature on December 31, 2008. Kettles Hill will then be obliged to refinance such amount. There is no assurance that such refinancing will be available on satisfactory terms and conditions. This may result in Kettles Hill being unable to pay principal and interest on the outstanding debt.

## Management's Responsibility for Financial Reporting

These consolidated financial statements form the basis for all the financial information that appears in this annual report. The financial statements and all of the information in this annual report are the responsibility of the management of Creststreet Kettles Hill Windpower LP and have been reviewed and approved by its board of directors. The board of directors is responsible for ensuring that management fulfills its financial reporting responsibilities.

Management has prepared the financial statements according to Canadian generally accepted accounting principles ("GAAP"). Under these principles, management has made certain estimates and assumptions that are reflected in the financial statements and notes. Management believes that these financial statements fairly present the entity's financial position and results of operations. Management has a system of internal controls designed to provide reasonable assurance that our financial records are reliable and form a proper basis for preparing the financial statements, and that our assets are properly accounted for and safeguarded.

Ernst & Young LLP, the unitholders' external auditors, have audited the consolidated financial statements in accordance with Canadian GAAP and their report is included below. Ernst & Young LLP has free and full access to the board's audit committee.



**Eric McFadden**

President  
Chief Executive Officer  
Creststreet Kettles Hill Windpower General Partner



**Derren Newell**

Vice-President, Finance  
Chief Financial Officer  
Creststreet Kettles Hill Windpower General Partner

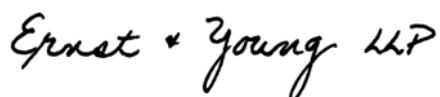
March 23, 2007

## Auditors' Report to the Partners of Creststreet Kettles Hill Windpower LP

We have audited the consolidated balance sheets of Creststreet Kettles Hill Windpower LP (the "Partnership") as at December 31, 2006 and 2005, and the consolidated statements of loss and deficit, partners' capital and cash flows for the years then ended. These financial statements are the responsibility of the Partnership'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 Partnership as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in black ink that reads "Ernst & Young LLP". The signature is written in a cursive, flowing style.

**Chartered Accountants**

Montreal, Canada

March 23, 2007

## Consolidated Balance Sheets

(In Thousands)

**As at December 31** **2006** 2005

### Assets

#### Current Assets

Cash	\$ 268	\$ 507
Cash held in escrow (Note 5)	4,224	2,904
Accounts receivable	1,602	1,041
Prepaid expense	80	59
Due from Parent	-	-
Due from related parties (Note 9)	16	-
	<b>6,190</b>	4,511

Derivatives (Note 4)	-	29
Deferred financing charges, deposits and pre-operating costs (Note 8)	3,251	2,864
Cash held in escrow (Note 5)	8,833	-
Construction in progress (Note 6)	62,146	38,842
Plant and equipment (Note 7)	30,160	-
Intangible assets (Note 3)	2,579	2,014
	<b>\$ 113,159</b>	<b>\$ 48,260</b>

### Liabilities

#### Current Liabilities

Accounts payable and accrued liabilities	4,492	5,696
Deferred revenue (Note 14)	23	-
Due to related parties (Note 9)	1,880	147
	<b>6,395</b>	5,843

Subordinated note payable (Notes 9 & 10)	32,841	900
Senior debt (Note 10)	33,750	-
Asset retirement obligation (Note 13)	231	-
Future income tax liability (Note 17)	8,322	1,151
Non-controlling interest (Note 3)	4,348	4,416
	<b>85,887</b>	12,310

Partners' capital (Notes 11 & 12)	28,694	36,624
Deficit	(1,422)	(674)
	<b>\$ 113,159</b>	<b>\$ 48,260</b>

Commitments (Note 14)

See accompanying notes to consolidated financial statements.

Approved by Creststreet Kettles Hill Windpower General Partner Limited  
as General Partner on behalf of Creststreet Kettles Hill Windpower LP



**Eric McFadden**  
Director



**John P. A. Budreski**  
Director

## Consolidated Statements of Loss and Deficit

(In Thousands, except per unit data)

For the years ended December 31	2006	2005
		(Note 1)
<b>Revenue</b>		
Electricity sales	\$ 1,480	\$ -
Investment income	197	96
Total revenue	1,677	96
<b>Expenses</b>		
Operating costs	319	-
Management fees (Note 9)	792	599
Administrative costs	448	171
Total expenses	1,559	770
Earnings (loss) before the undernoted	118	(674)
Amortization of plant and equipment (Note 7)	1,300	-
Amortization of intangible assets	112	-
Amortization of deferred charges and pre-operating costs (Note 8)	490	-
Foreign exchange gain on derivatives & others (Note 4)	(33)	-
Interest expense	577	-
Loss before taxes and non-controlling interest	(2,328)	(674)
Future income tax recovery (Note 17)	1,512	-
Non-controlling interest (Note 3)	68	-
Net loss	(748)	(674)
Deficit, beginning of period	(674)	-
Deficit, end of period	\$ (1,422)	\$ (674)
Net loss per unit - basic and diluted	\$ (0.19)	\$ (0.36)
Weighted average number of units (Note 11)	4,000	1,880

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Partners' Capital

(In Thousands)

For the years ended December 31	2006	2005
		(Note 1)
Partners' capital - beginning of period	\$ 36,624	\$ -
Proceeds from initial public offering (Note 11)	-	40,000
Payment of costs of Issue (Note 11)	-	(676)
Payment of agents' fees (Note 11)	-	(2,700)
Contributed surplus (Note 9)	76	-
Future income tax resulting from renunciation (Note 12)	(8,006)	-
Partners' capital - end of period	\$ 28,694	\$ 36,624

See accompanying notes to consolidated financial statements.

## Consolidated Statements of Cash Flows

(In Thousands)

For the years ended December 31

	2006	2005 (Note 1)
<b>Cash flows from operating activities</b>		
Net loss	\$ (748)	\$ (674)
Add (deduct) items not affecting cash:		
Future income tax recovery (Note 16)	(1,512)	-
Amortization of plant and equipment (Note 7)	1,300	-
Amortization of intangible asset	112	-
Amortization of deferred charges and pre-operating costs (Note 8)	490	-
Accretion of asset retirement obligation (Note 13)	13	-
Accretion of interest expense (Note 9)	17	-
Foreign exchange gain on derivatives (Note 4)	(33)	-
Non-controlling interest (Note 2)	(68)	-
	<b>(429)</b>	<b>(674)</b>
<b>Non-cash operating working capital</b>		
Increase in accounts receivable	(561)	(871)
Increase in deposits (Note 8)	(50)	(38)
Increase in prepaid expense	(21)	(59)
Increase in accounts payable accrued liabilities	98	181
Increase in deferred revenue (Note 14)	23	-
Increase in amounts due to (from) related parties (Note 9)	1,717	147
	<b>776</b>	<b>(1,314)</b>
<b>Cash flows from financing activities</b>		
Proceeds from issue of units (Note 11)	-	40,000
Cost of issuing / agent fees (Note 11)	-	(3,376)
Redemption of preferred shares held by non-controlling interest	-	(1,225)
Issue of subordinated notes by subsidiary to related party (Note 9)	32,000	900
Increase in senior debt (Note 9)	33,750	-
Increase in deferred financing fees (Note 8)	(782)	(1,243)
Preferred share dividend by subsidiary (Note 9)	-	(47)
	<b>64,968</b>	<b>35,009</b>
<b>Cash flow from investing activities</b>		
Increase in cash held in escrow (Note 5)	(10,153)	(2,904)
Additions to plant and equipment and construction-in-progress (Notes 6 and 7)	(55,762)	(28,521)
Increase in pre-operating costs (Note 8)	(229)	(1,763)
Proceeds from foreign exchange option exercise (Note 4)	161	-
	<b>(65,983)</b>	<b>(33,188)</b>
Net increase (decrease) in cash	(239)	507
Cash and cash equivalents, beginning of period	507	-
<b>Cash and cash equivalents, end of period</b>	<b>\$ 268</b>	<b>\$ 507</b>
<b>Supplemental cash information</b>		
Interest paid	\$ 261	\$ -

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

As of December 31, 2006 and 2005

(All tabular amounts stated in thousands of dollars, except per unit information)

### 1. Business and Structure of the Partnership

Creststreet Windpower (II) LP was established as a limited partnership under the laws of the Province of Ontario on January 30, 2004. Effective on April 28, 2005, Creststreet Windpower (II) LP changed its name to Creststreet Kettles Hill Windpower LP (the "Partnership"). The Partnership was established to invest in flow-through shares and subordinated notes of Kettles Hill Wind Energy Inc. ("Kettles Hill"), a Canadian company that is constructing and will then operate a wind energy project to generate electricity for sale to the Alberta power market at then prevailing market prices. At December 31, 2004, the Partnership had issued 10 units for \$10 in cash consideration. The Partnership completed its initial public offering on July 11, 2005 issuing 4.00 million Partnership units for \$40.00 million cash consideration and commenced developmental activities.

In March 2006, commercial production of the initial phase of the project (the "CRCE Phase") at Kettles Hill commenced with the project entering its 120-day test period required to qualify expenses for test turbines under the Canadian Renewable and Conservation Expense tax rules. This test period was completed in July 2006. Prior to March 2006, the Partnership was considered to be in the development stage.

As the 120-day test period is now complete, work to install and commission the remaining 30 wind turbines for the second phase of the project (the "Infill Phase") has begun.

The general partner of the Partnership is Creststreet Kettles Hill Windpower General Partner Limited ("General Partner"). The General Partner has a 0.01% beneficial interest in the Partnership. The Partnership has a Management Agreement with Creststreet Kettles Hill Windpower Management Limited (the "Manager"), a subsidiary of Creststreet Capital Corporation ("CCC"), pursuant to which the Manager will perform certain management, administration and other services for the Partnership.

These financial statements present the consolidated financial position and results of operations of the Partnership and accordingly, do not, and are not intended to, include all the assets, liabilities, revenues and expenses of the Partners. No provision has been made for income taxes as the Partners are taxable individually on their share of the Partnership's net loss. Tax amount related to Kettles Hill are incorporated into the financial statements on consolidation.

### 2. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The accounting principles applied are consistent with those as set out in the Partnership's annual consolidated financial statements for the year ended December 31, 2005 except as noted below. The Partnership's earnings are

dependent on the amount of wind resources, which is subject to season fluctuations with the highest level of revenue during the winter months (generally, the first and fourth quarters).

The following is a summary of significant accounting policies followed by the Partnership:

**(a) Consolidation**

The accompanying consolidated financial statements include the accounts of the partnership and its subsidiary, Kettles Hill. All significant intercompany transactions and balances have been eliminated.

Pursuant to a flow-through share agreement in 2005 between the Partnership and Kettles Hill, as at December 31, 2006 the Partnership owns 83.15% of the voting shares of Kettles Hill, and Creststreet Windpower Development LP ("CWDLP"), a related party owns 16.85% of the voting shares of Kettles Hill.

**(b) Cash and Cash Equivalents**

Cash includes cash on hand and bank balances. Cash equivalents are comprised of highly liquid investments having original terms to maturity of 90 days or less when acquired. Cash equivalents are valued at cost plus accrued interest, which approximates market value.

**(c) Limited Partnership Unit Issue Costs**

Costs incurred in connection with the issuance of units are deducted from the proceeds of the offering of units included in Partners' Capital.

**(d) Construction in Progress and Plant and Equipment**

The assets of Kettles Hill are recorded at cost. Cost includes construction in progress and the cost of acquiring and constructing support facilities and wind turbines. Interest on debt incurred to construct plant and equipment is capitalized during the construction period. The construction in progress will be transferred to plant and equipment once commercial production commences. At the time of transfer, amortization on a straight-line basis over 20 years will commence.

In March 2006, Kettles Hill commenced commercial operations of the CRCE Phase of the wind energy project; therefore the costs associated with the CRCE Phase construction in progress were reclassified to plant and equipment.

The capital assets are being constructed on leased land. Kettles Hill has entered into four lease agreements with terms of each lease being 20 years, renewable for up to a further two, 20 year terms.

**(e) Impairment of Long-lived Assets**

An impairment loss on long-lived assets to be held and used will be recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value. The Partnership reviews its long-lived assets whenever events or changes in circumstance indicate that the carrying amount may not be recoverable. There was no impairment loss recognized for the year ended December 31, 2006 and 2005.

**(f) Deferred Charges and Pre-operating Costs**

Financing costs are deferred and amortized on a straight-line basis over the expected life of the related facility, commencing on the date the financing agreement was entered into. Upon early termination of a facility, the unamortized balance of financing cost is written-off. The amortization is capitalized to construction in progress during the construction period.

Expenditures that relate directly to placing a new business into service but do not qualify as plant and equipment occurring during the pre-operating period are capitalized to pre-operating assets. These are being amortized over a five year period. The pre-operating period began with the development of the site and will end when commercial operations commences.

**(g) Revenue Recognition**

Revenue from electricity sales is recorded at the time electrical energy is delivered in the Alberta Power Pool. Interest and investment income is recognized as earned.

**(h) Derivative Instruments**

Option agreements are used to reduce foreign currency exposure on construction contracts. Kettles Hill does not enter into option agreements for trading or speculative purposes. However, the option agreements did not qualify for hedge accounting and, as such, are recorded at their fair value on the balance sheet as either an asset or liability, with changes in fair value deferred under pre-operating assets during the pre-operating period and expensed once commercial operations began.

**(i) Income Taxes**

The Partnership is not a taxable entity. Income taxes on its income are the responsibility of the individual partners and have accordingly not been recorded in these consolidated financial statements.

Kettles Hill is a taxable Canadian corporation, subject to federal and provincial income taxes and capital taxes. The corporation accounts for income taxes under the asset and liability method. Under this method, future tax assets and liabilities are recognized for future tax consequences attributable to differences between financial statement carrying

value and the tax basis of assets and liabilities. Future tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected, recovered or settled. A valuation allowance is provided to record the future tax asset at the amount that is more likely than not to be recovered.

#### **Proposed Canadian income tax rule changes**

On October 31, 2006, the Minister of Finance (Canada) announced new tax proposals concerning the taxation of publicly traded income trusts and other flow-through entities. The October 31, 2006 proposal was followed by the release of draft legislation by the Department of Finance on December 21, 2006. The 2006 Proposed Amendments, if enacted as currently drafted, will not subject the Partnership to trust level taxation as of January 1, 2011 as the Partnership is not listed on a stock exchange. As such, the taxable distributions received by investors from the Partnership, would not be treated as taxable dividends. If the Partnership was listed on a stock exchange, these rules would apply.

#### **(j) Non Controlling Interest**

Non controlling interest on the balance sheet represents the 16.85% interest held by CWDLP in the Class A voting shares of Kettles Hill at December 31, 2006 and the nominal interest of the Class B non-voting shares of Kettles Hill.

#### **(k) Use of Estimates**

The preparation of consolidated financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates on future periods could be significant.

#### **(l) Loss per Unit**

Net loss per unit is calculated by dividing net loss by the weighted-average number of units outstanding during the period. For the purpose of the weighted-average number of units outstanding, units are determined to be outstanding from the date they are issued.

#### **(m) Foreign Currency Translation**

Monetary assets and liabilities are translated into Canadian dollars at the rates in effect at the balance sheet date. Other assets and liabilities are translated at the rates prevailing at the transaction dates. Revenues and expenses are translated at the average exchange rates prevailing during the year, except for depreciation and amortization, which is translated at exchange rates prevailing when the related assets were acquired. Gains and

losses arising from the fluctuations in exchange rates are reflected in earnings, after commercial operations commences and in pre-operating costs prior to commencement.

**(n) Asset Retirement Obligation**

Accounting for Asset Retirement Obligations requires Kettles Hill to record an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. The provisions of Section 3110 of the Canadian Institute of Chartered Accountants (“CICA”) handbook require the asset retirement obligations to be recorded at fair value at the time the liability is incurred. Accretion expense is recognized as an operating expense using the credit-adjusted risk-free interest rate in effect when the liability was recognized. The associated asset retirement obligations are capitalized as part of the carrying amount of the long-lived asset and depreciated over the estimated useful life of the asset. Kettles Hill has recorded asset retirement obligations primarily associated with certain closure, reclamation and restoration costs of the wind energy turbines.

As required under the standard, Kettles Hill will make periodic assessments as to the reasonableness of the asset retirement obligation estimates and revise those estimates accordingly.

**(o) Deferred Revenue**

From time to time, Kettles Hill enters into contracts for the sale of renewable energy certificates from the electricity produced. The revenue generated from these contracts will be recognized on an annual basis, within forty–five days after the end of each calendar year, upon an executed transfer of title of the renewable energy certificates by Kettles Hill to the customer.

**(p) Intangible Assets**

Intangible assets are amortized on a straight-line basis over 20 years.

**(q) Prior Year Balances**

Certain prior year balances have been reclassified to conform to the presentation adopted in the current year.

**3. Acquisition**

In 2005, the Partnership acquired from a related party, with common management, 17.77 million Class A shares of Kettles Hill for \$23.81 million. The Class A shares were issued from treasury and resulted in the Partnership obtaining 83.15% interest in the net assets of Kettles Hill.

The acquisition was recorded at the exchange amount and was accounted for using the purchase method, and accordingly, the results were included in the consolidated financial statements since the acquisition date.

Cash	\$23,813
Other current assets	170
Other long-term assets	6,775
Intangible Assets	2,691
Current liabilities	(2,120)
Future tax liability	(1,828)
Minority interest	(5,688)
<b>Net assets acquired</b>	<b>23,813</b>
Consideration comprised	
Cash	\$23,813

As the acquisition of Kettles Hill resulted from the issuance of treasury stock of Kettles Hill, there was no impact on the consolidated statement of cash flows.

During 2006, the purchase equation was adjusted to reflect a reclassification of an amount previously shown as goodwill to intangible assets. The revised purchase price allocation is reflected above. As the amount of this adjustment was not deemed to have a material effect, comparative amounts have not been restated.

#### 4. Derivatives Instruments

As at December 31, 2006, Kettles Hill no longer held any option agreements. In 2005, Kettles Hill entered into option agreements to purchase (i) €20.00 million at exercise price of C\$1.5100 per EUR for consideration of \$510,000, expired unexercised on July 5, 2005; (ii) €5.0 million at an exercise price of C\$1.5100 per EUR for consideration of \$168,000, expired unexercised on April 7, 2006; (iii) €10.0 million at an exercise price of C\$1.5100 per EUR for consideration of \$349,000, expired unexercised on April 28, 2006; (iv) €5.00 million at an exercise price of C\$1.5100 per EUR for consideration of \$206,000, expired unexercised on June 15, 2006.

During 2006, Kettles Hill entered into two additional option agreements. An agreement to purchase €5.00 million at an exercise price of C\$ 1.5100 per EUR for consideration of \$28,000 was entered into on February 15, 2006 and expired unexercised on June 30, 2006 and an agreement to purchase €7.00 million at an exercise price of C\$1.4170 per EUR for consideration of \$143,000 was entered into on February 21, 2006. This option to purchase EUR \$7.00 million was exercised on July 31, 2006, prior to its expiry resulting in settlement proceeds of \$161,000 being received by Kettles Hill in August which was recorded in the income statement.

These option agreements were used to reduce foreign exchange rate exposure on purchases of wind turbines and were not entered into for trading or speculative purposes. They do not qualify for hedge accounting and, as such, are recorded at their fair value on the consolidated balance sheet. The total cost of \$1.40 million paid to enter these agreements was capitalized to pre-operating costs, prior to commencement of commercial operations. As at December 31,

2006, the unrealized foreign exchange loss on these option agreements was \$nil (2005 - \$1.30 million).

## 5. Cash held in Escrow

Kettles Hill entered into an escrow agreement dated June 30, 2005 in connection with its obligation of \$4.80 million to Vestas-Canadian Wind Technology Inc. ("Vestas") for CRCE Phase turbines. The amount of \$3.20 million was released when the CRCE Phase turbines were delivered and a further \$1.48 million was released when the turbines had been commissioned and the required performance tests had been completed. The remaining balance of \$117,000 was released in the fourth quarter of 2006. Total released for the year ended December 31, 2006 was \$2.90 million (2005 - \$1.90 million).

Cash held in escrow also includes amounts advanced to Kettles Hill through its credit facility with a major Canadian financial institution and \$1.00 million advanced from Creststreet Power & Income Fund LP ("CPIF"), a related party with common management, committed to invest in subordinated notes of Kettles Hill to help complete the funding requirements of the project. These funds may only be accessed for construction related expenses upon the acceptance of the lender. Of the \$34.75 million deposited during the year, \$21.69 million was released as at December 31, 2006 (2005 - \$nil).

## 6. Construction In Progress

	December 31, 2006	December 31, 2005
<b>CRCE Phase</b>		
Construction in progress, beginning of period	<b>\$25,142</b>	\$ -
Additions	<b>5,574</b>	25,142
	<b>30,716</b>	25,142
Amount transferred to plant and equipment (i)	<b>(30,716)</b>	-
	-	25,142
<b>Infill Phase</b>		
Construction in progress, beginning of period	<b>13,700</b>	-
Additions	<b>48,446</b>	13,700
	<b>62,146</b>	13,700
Construction in progress, end of period	<b>\$62,146</b>	\$38,842

- (i) In March 2006, Kettles Hill commenced commercial operations of the CRCE Phase of the wind energy project; therefore the costs associated with the CRCE Phase construction in progress were reclassified to plant and equipment (see note 7 below).

## 7. Plant & Equipment

	December 31, 2006	December 31, 2005
Kettles Hill Plant and Equipment	\$30,716	\$ -
Additions	744	-
	<b>31,460</b>	
Less: accumulated depreciation	<b>(1,300)</b>	
Total	<b>\$30,160</b>	\$ -

As at December 31, 2006, the asset retirement obligation amounted to \$216,070, which is primarily associated with certain closure, reclamation and restoration costs for the wind energy turbines.

## 8. Deferred Financing Charges, Deposits and Pre-operating Costs

During the fourth quarter of 2005, Kettles Hill entered into a credit facility with a major Canadian financial institution. As at December 31, 2006, the fees and expenses charged to enter into this facility and to complete the steps for the first advance of this credit facility totaled \$2.03 million (2005 - \$1.24 million). Accumulated amortization of the deferred financing costs amounted to \$381,000 of which \$186,185 (2005 - \$nil) was expensed during the year ended December 31, 2006. Prior to March 2006, \$46,429 (2005 - \$11,060) was capitalized to the CRCE Phase and a further \$118,502 (2005 - \$nil) was capitalized to the Infill Phase.

As at December 31, 2006, Kettles Hill has capitalized \$1.82 million (2005 - \$1.62 million) of pre-operating costs, which is being amortized over a five-year period beginning March 1, 2006. Amortization of the pre-operating costs amounted to \$303,511 (2005 - \$nil).

As at December 31, 2006, Kettles Hill has a receivable of \$38,000, for a security deposit paid to Alberta Electric System Operator ("AESO"). The deposit was paid to cover any obligations estimated to be owing to them for a 60 day period, in relation to the purchase of energy & transmission by Kettles Hill. During 2006, Kettles Hill also paid \$50,000 deposit to AESO for a stage one application for a future interconnection.

## 9. Related Party Transactions

### Payments to General Partner

The General Partner is reimbursed for reasonable costs incurred by it in acting as registrar and transfer agent and in attending to the administration of the Partnership. During the course of 2006 no payments were made (2005 - \$nil).

### Payments to the Manager

The Partnership has entered into a Management Agreement with the Manager dated May 31, 2005. The Manager is entitled to a base fee equal to \$40,000 per month from completion of the initial public offering until December 31, 2006 and thereafter, a monthly fee equal to \$41,667, payable monthly in arrears, and increased every 12 months in accordance with the percentage

increases in the Canadian Consumer Price Index (the "CPI"). The Manager is also entitled to an incentive fee per unit outstanding as at December 31 of each year, payable annually, equal to 25% of the amount by which the three-year rolling average of cash distributions (except in 2008, in which cash distributions for the year will be used and in 2009, when the average of cash distributions in 2008 and 2009 will be used), calculated on a per unit basis, exceeds \$1.00 per unit. The initial term of the agreement is 20 years, automatically renewable for further five-year terms unless terminated under the terms of the Management Agreement.

As part of the Management Agreement, the Manager was paid a one-time fee of \$320,000 upon completion of the initial public offering in 2005.

In 2006, the Manager earned \$511,200 (2005- \$599,200) under this agreement. The Manager is also entitled to reimbursement of its operating expenses incurred in providing the services under the Management Agreement. The total reimbursed in 2006 was \$356,181 (2005 - \$64,140) was reimbursed to the Manager.

### **Related Party Transactions**

Kettles Hill has entered a Financial Administration Agreement ("FAA") dated May 31, 2005 with Creststreet Capital Corporation ("CCC"), a related party with common management, to maintain the minute books and records of the Company and to provide it with other general accounting and cash management services in return for the reimbursement of expenses and a fee of \$1,500 per month in the first year of the agreement, and thereafter a fee of \$7,500 per month for the remaining term of four years, subject to adjustments and inflation. The total incurred for the year ended December 31, 2006 was \$18,000 (2005 - \$9,000).

Kettles Hill has entered into a Consulting Service Agreement ("CSA") with a shareholder, Benign Energy Canada Inc. ("BECI"). The CSA has a term ending on the date of substantial completion of the Infill Phase. BECI will assist with supervision of the construction and administration of the Engineering, Procurement and Construction Services ("EPCS") and Turbine Supply Agreement ("TSA"). BECI will be paid:

- i. A consulting fee of \$1.00 million, of which \$320,000 payable upon substantial completion of CRCE Phase which occurred in 2006, \$320,000 on substantial completion of Infill Phase, and equal monthly installments of \$30,000 each beginning in August 2005 and ended 12 months later.
- ii. An incentive fee equal to 25% of the remaining unused contingency, payable upon substantial completion of CRCE Phase and Infill Phase. The maximum fee payable to BECI under the Consulting Service Agreement is \$1.87 million. In addition to this, BECI will be reimbursed for any out-of pocket expenses incurred in providing the services.

Kettles Hill has entered into a Management Services Agreement ("MSA") with BECI to assist in the day-to-day operations of the facility which has an initial term of five years and will be renewed automatically unless BECI provides one year's prior written notice of its intention not to renew. BECI will be paid a monthly base fee of \$6,666 from the substantial completion of CRCE Phase until substantial completion of the Infill Phase, following which the monthly base

fee shall be increased to \$16,666, indexed to inflation. BECI will be reimbursed for any out of pocket expenses.

For the year ended December 31, 2006, fees charged by BECI in accordance with the CSA and MSA, including reimbursement for out-of-pocket expenses amounted to \$617,894 (2005 - \$200,210).

On October 29, 2004, Kettles Hill issued 1,225 non-voting preferred shares to BECI for \$1.23 million with a cumulative dividend of 7% per annum. On July 11, 2005, the preferred shares were redeemed at the price of \$1 per share for \$1.23 million and \$47,456 of cumulative dividends were paid at the same time.

BECI and Creststreet Power Holdings Limited own Class B shares of Kettles Hill. Holders of the Class B shares will be entitled to 5% of revenue (excluding WPPI).

In 2005, Kettles Hill entered into a subordinated note with Creststreet Windpower Development LP ("CWDLP"), a related party with common management for \$900,000 to finance pre-development costs which is due on July 31, 2025. Interest is charged at a rate of 10% per annum. The note is redeemable at any time after July 31, 2015 by Kettles Hill at par plus accrued interest. If there is a change in ownership the debt is redeemable at 105% of par plus accrued interest, unless waived in writing by CWDLP. Interest payments are deferred until the earlier of December 31, 2006 or completion of the Infill Phase whereby greater than 30 turbines are commissioned. As at December 31, 2006, the Partnership had incurred \$90,000 of interest during the year, of which \$14,548 (2005 - \$64,473) was capitalized during the construction period and \$75,452 (2005 - \$nil) expensed to the statement of loss and deficit once commercial operations began for the CRCE Phase.

On December 19, 2005, CPIF, a related party with common management, committed to invest in subordinated notes of Kettles Hill (the "CPIF Notes") to help complete the funding requirements of the project. CPIF committed to invest up to \$31.00 million in subordinated notes. By the end of the third quarter of 2006 CPIF had invested the full \$31.00 million commitment. Additional investments by CPIF of up to \$4.90 million in notes to Kettles Hill were approved at a special meeting of CPIF Unitholders on September 6, 2006. In the fourth quarter of 2006, CPIF invested an additional \$1.00 million, bringing its total investment to \$32.00 million by the end of 2006. On November 29, 2006 CPIF announced an additional \$2.00 million will be invested in Kettles Hill by the end of the first quarter of 2007 subject to certain conditions, of which the full \$2.00 million has been invested subsequent to December 31, 2006.

During the third quarter of 2006, the terms of the \$6.50 million CPIF Notes previously outstanding were amended to match the terms of the \$24.50 million of CPIF Notes that were issued during the third quarter. The CPIF Notes terms now include an interest rate of 9.25% per annum until October 31, 2009 and thereafter at a rate of 10.5%. Interest on the notes will accrue monthly. Previously the interest rate was 8.25% per annum until October 31, 2009 and then 9.25% thereafter. Interest payments are deferred until the earlier of September 30, 2007 or 60 days after completion of the Infill Phase. The conversion option has been replaced by a redemption feature that requires the Partnership to purchase these notes at 110% of par plus 50% of the amount, if any, that the fair market value of each Class A share of Kettles Hill,

realized upon a change of control, exceeds \$1.87 per Class A share multiplied by the principal amount of the Kettles Hill subordinated notes held by CPIF divided by \$1.70 if Kettles Hill is purchased by a third party other than CPIF. If the Partnership is acquired by CPIF the maturity of the subordinated notes extends to October 31, 2026 from October 31, 2009. As a result of the removal of the conversion feature of the subordinated note, \$76,471 has been reclassified from Equity component of subordinated note payable to Contributed Surplus.

The payment of the principal of, and interest on all, the subordinated notes is fully subordinated to the credit facility. The payment of interest on the subordinated notes will rank in priority to the payment of interest only on other subordinated indebtedness and the payment of principal on the subordinated notes will rank pari passu with the payment of principal on other subordinated indebtedness of Kettles Hill.

As at December 31, 2006, the Partnership has incurred \$1.32 million (2005 - \$nil) of interest, of which \$23,733 (2005 - \$nil) was capitalized to Pre-operating costs during the CRCE Phase, \$817,192 (2005 - \$nil) was capitalized to Construction-in-progress during the Infill Phase and \$480,582 (2005 - \$nil) interest expensed to the income statement on all investments over the original. A financing fee of \$50,000 (2005 - \$nil) was charged by CPIF for the issuance of CPIF Notes for all investments over the original \$31.00 million, this financing charge was capitalized.

The current amounts due (to) from related parties as at December 31, 2006 are as follows:

December 31	<b>2006</b>	2005
CCC	<b>\$(320)</b>	\$(43)
CWDLP	<b>(187)</b>	(104)
BECI	<b>(51)</b>	-
CHL	-	-
CPIF	<b>(1,322)</b>	-
Dokie Wind Energy Inc.	<b>5</b>	-
Benchland Wind Power Corp.	<b>11</b>	-
	<b>\$(1,864)</b>	\$(147)

## 10. Credit Facilities

<b>Facility</b>	<b>Available Credit</b>	<b>Amount Advanced</b>	<b>Interest</b>	<b>Maturity</b>
Subordinated Notes				
– CPIF	\$34,000	\$ 32,000	9.25%	October 31, 2009
– CWDLP	\$900	\$900	10%	July 31, 2025
Credit Facilities				
Tranche A	13,750	13,750	5.92%	December 31, 2008
Tranche A2	8,750	-	11.52%	December 31, 2008
Tranche B	20,000	20,000	6.11%	December 31, 2016
Tranche C	5,000	-	12.00%	December 31, 2008
<b>Total</b>	<b>\$82,400</b>	<b>\$ 66,650</b>		

See related party note 9 for detail on the subordinated notes – CPIF and CDWLP.

On December 19, 2005, Kettles Hill announced the closing of a \$42.5 million credit facility to finance a portion of the construction of the Infill Phase with a major Canadian financial institution. On September 14, 2006, Tranche B of the credit facility was advanced as a construction loan. On December 22, 2006, \$13.75 million of Tranche A was advanced as a construction loan. Amounts not drawn by the earlier of the completion of construction of the Infill Phase and December 31, 2006, will be cancelled. All outstanding amounts in the construction loan will be converted to a term loan upon completion of the construction of the Infill Phase.

During the second quarter of 2006 this credit facility was amended, to reflect the construction delays that had occurred, by extending the timing of the first advance under the facility from June 30, 2006 to September 30, 2006.

On August 4, 2006, \$8.75 million of Tranche A became subject to Kettles Hill receiving confirmation that it will receive contributions from the Canadian federal government's Wind Power Production Incentive ("WPPI") program or an equivalent program. If confirmation of the contribution is received, this \$8.75 million advance will use the interest rate mechanism described below using the credit spread for Tranche A shown in the following table. If the WPPI contribution is received, this portion of the loan will not require principal payments consistent with the rest of the loan. If the WPPI contribution is not received, this advance's interest rate will then be calculated using the Government of Canada long bond yield for Tranche A described below but will use the credit spread for Tranche A2 shown in the table below. As well, if the WPPI contribution is not received this portion of the loan will require principal payments of \$2.0 million per year until March 31, 2009.

In the fourth quarter of 2006, Kettles Hill negotiated a \$5.0 million subordinated debt facility with a major Canadian financial institution as an additional tranche (Tranche C) to provide additional liquidity to finance a portion of the cost increases and to also provide additional liquidity in the event that there may be potential cost increases, during the construction of the Infill Phase. This facility, which matures on December 31, 2008, bears interest at 12% per annum and requires excess cash flow as defined by the agreement to be used to partially repay outstanding balances in excess of \$2 million prior to December 31, 2008. The other terms and conditions are standard for this type of facility.

Repayment of the credit facility is interest only until maturity except as described above. Interest for both Tranche A and B is based on the long bond yield on the date of the first advance for each respective tranche plus a credit spread, compounded and payable monthly in arrears. The long bond yield for Tranche A is the mid-market semi-annual interpolated yield of the Government of Canada 6% Bond due June 1, 2008 and the Government of Canada 5.5% Bond due June 1, 2009 based on a term to maturity ending approximately on December 31, 2008. Interest for Tranche A was determined one day prior to the advance at 5.92%. The long bond yield for Tranche B is the mid-market semi-annual interpolated yield of the Government of Canada 4.5% Bond due June 1, 2015 and the Government of Canada 9.25% Bond due June 1, 2022 based on a term to maturity ending approximately on December 31, 2016. Interest for Tranche B was determined one day prior to the advance at 6.11%.

The credit spread is:

Credit Spread	To December 31, 2008	After December 31, 2008
Tranche A	200 bps	N/A
Tranche A2	750 bps	N/A
Tranche B	200 bps	175 bps

As at December 31, 2006, the average effective interest rate for the \$42.5 million construction loan facility if drawn and if Kettles Hill receives the WPPI contribution, would be 6.01%. If Kettles Hill is not eligible for WPPI or if the program ceases to exist, the effective interest rate on this loan will be 7.16%.

As at December 31, 2006 the Partnership has incurred \$387,227 (2005 - \$nil) of interest on the credit facility advanced by major financial institution, which was capitalized to Construction-in-progress during the Infill Phase.

## 11. Partnership Units

As at December 31, 2006, the Partnership has 4.00 million units outstanding. The partnership may issue an unlimited number of voting units.

On July 11, 2005 the Partnership issued 4,000,000 voting limited partnership units for a total consideration of \$40.00 million before the deduction of issuance costs. The Partnership paid agents fees of \$2.70 million being 6.75% of the gross proceeds raised through registered dealers and incurred \$676,000 in issue costs to complete the offering.

## 12. Flow Through Shares

Resource expenditure deductions for income tax purposes related to development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Pursuant to the terms of flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, shareholders' equity of Kettles Hill will be reduced and a future tax liability will be recorded equal to the estimated amount of future income taxes payable as a result of the renunciations, when the renunciations are made. Renunciations made during 2006 resulted in a future tax liability of \$8.01 million (2005 - \$1.15 million).

## 13. Asset Retirement Obligation

The following table presents the reconciliation of the beginning and ending aggregate carrying amounts of the obligation associated with the retirement of wind farm properties.

	December 31, 2006	December 31, 2005
Asset retirement obligation, beginning of period	\$ -	\$ -
Liabilities incurred	218	-
Accretion expense	13	-
Asset retirement obligation, end of period	<b>\$ 231</b>	\$ -

The total undiscounted amount of estimated cash flows required to settle the obligation at December 31, 2006 was \$1.31 million (2005 - \$nil million). This amount was then adjusted for inflation at a rate of 2% and it was discounted using a credit adjusted risk free rate of 10.72%. Most of these obligations are not expected to be paid for 20 years and will be funded from general company resources at that time.

Asset retirement obligations are primarily associated with certain closure, reclamation and restoration costs related to retirement of the wind farm properties. Actual obligations could differ from these estimates. Revisions to the Partnership's asset retirement obligation will be made prospectively if new information is available.

## 14. Commitments

(In \$ millions)	Total	Due less than 1 year	Due 2 to 3 years	Due 4 to 5 years	Due after 5 years
Long-term debt obligations	\$66.65	\$ -	\$45.75	\$ -	\$20.90
WMS agreement Land lease (see below) Other construction agreements (see below)	5.55	0.88	2.27	2.28	0.12
<b>Total obligations</b>	<b>\$72.20</b>	<b>\$0.88</b>	<b>\$48.02</b>	<b>\$2.28</b>	<b>\$21.02</b>

Kettles Hill has entered into four lease agreements with respect to the site for the wind energy project. The term of each lease agreement is 20 years, renewable for up to a further two, 20 year terms. The annual rent payable under each lease agreement is 2.5% of electricity revenue.

Kettles Hill entered into a Warranty, Maintenance and Service Agreements (“WMS Agreement”) with Vestas – Canadian Wind Technology (“Vestas”), which provides for certain warranties in connection with the wind turbines installed at the wind energy project, and ongoing service and maintenance obligations in connection with the turbines. The WMS Agreement includes a facility-wide warranty, which commences only upon substantial completion of the Infill Phase and is related to power curve performance and availability of the facility. In the event that the facility fails to perform as warranted, the WMS Agreement entitles Kettles Hill to liquidated damages to offset any lost revenue. The WMS Agreement is for a 5-year period commencing at the date that the turbines come into service at a cost of \$32,500 per turbine per annum. As at December 31, 2006, the total remaining commitment to Vestas under the WMS Agreement was \$5.55 million.

Kettles Hill has entered into an EPCS Agreement with Hatch Optima Ltd. to design all non-turbine related aspects of the project, purchase any non-turbine equipment and manage the construction. Costs are incurred on a time and material basis.

In 2005 Kettles Hill entered into an agreement with Plava Ventures Corp. to pay success fees of \$50,000 upon the closing of CRCE Phase construction financing which occurred in 2006 and another \$50,000 upon the completion of the Infill Phase construction.

In April 2006, Kettles Hill signed a contract for the sale of 30 gigawatt hour (“GWh”) of renewable energy certificates production to Baseline Emissions Management Inc. (“Baseline”). The revenue generated from this contract will be recognized on an annual basis within forty-five days after the end of each calendar year, upon an executed transfer of title of the renewable energy certificates by Kettles Hill to Baseline. A total of \$22,500 was recorded as deferred revenue at December 31, 2006 for a portion of the 2006 production. Additionally in June 2006, Kettles Hill entered into an agreement with the federal government for the sale of 46,000

tonnes of emissions reductions from 2007 production at a price of \$7.97 per tonne of CO<sub>2</sub> equivalent.

## 15. Financial Instruments

At December 31, 2006 and 2005, the carrying amount of cash, cash held in escrow, accounts receivable, accounts payable, accrued liabilities and due to related parties approximates fair value due to their short-term nature.

At December 31, 2006, the carrying amount of the subordinated notes payable approximate fair value due to the short period of the time that has elapsed between finalizing the terms of the agreements at the period end date.

The Partnership is exposed to foreign currency fluctuations, to the extent that purchases are denominated in foreign currencies.

The Partnership's credit facilities bear interest based on long bond yield plus a credit spread, and therefore are subject to risks related to interest rate fluctuations.

Accounts receivable include amounts receivable from electricity sales that are made to a large credit-worthy purchaser Alberta Electric System Operator. Accordingly, the Partnership views credit risks on these amounts as low.

## 16. Indemnification

Generally, it is not the Partnership's policy to issue guarantees to non-controlled affiliates or third parties, with limited exceptions.

Many of the Partnership's agreements, specifically those related to financing include indemnification provisions where the Partnership may be required to make payments to a vendor or purchaser for breach of fundamental representation and warranty terms in the agreements with respect to matters such as corporate status, title of assets, environmental issues, consents to transfer, employment matters, litigation, taxes payable and other potential material liabilities. The maximum potential amount of future payments that the Partnership could be required to make under these indemnification provisions is not reasonably quantifiable as certain indemnifications are not subject to a monetary limitation. At December 31, 2006, Management does not believe that these indemnification provisions would require any material cash payment by the Partnership.

## 17. Income Taxes

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2006 are presented below:

a. Income tax recovery has been determined as follows:

December 31	2006	2005
Total future tax recovery	<b>\$1,512</b>	\$ -

b. Effective tax rates related to net losses before income taxes are:

December 31	2006	2005
Net loss before income tax	<b>\$2,328</b>	\$674
Income (loss) of partnership taxed directly in the hands of the Unitholders	<b>37</b>	(534)
Loss of the partnership before taxes and after distribution of income to Unitholders	<b>\$2,365</b>	\$140
Canadian statutory rate	<b>32.12%</b>	32.49%
Income tax recovery based on statutory income tax rates	<b>760</b>	45
Valuation allowance	-	(45)
Changes in future income tax rates	<b>752</b>	\$ -
Total	<b>\$1,512</b>	\$ -

c. The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2006 are presented below:

December	2006	2005
Future tax assets:		
Unused tax losses	<b>\$279</b>	\$ -
Future tax liabilities:		
Capital assets – differences in net book value and undepreciated capital cost	<b>(8,601)</b>	(1,151)
Net future tax liability	<b>(\$8,322)</b>	(\$1,151)

## 18. Economic Dependence

For the period ended December 31, 2006, the Partnership was dependent on Alberta Electric System Operator for 100% of its revenue from electricity sales.

## 19. Subsequent Event

On March 5, 2007, the Partnership engaged an independent financial advisor to provide financial advice on future possible transactions with respect to providing liquidity to the Limited Partners. The Partnership is committed to paying the advisor up to \$100,000 plus a success fee based on the transaction value.

## Creststreet Kettles Hill Windpower General Partner Limited

### Directors of the General Partner

**Terry L. Allen**

President  
Pivotal Capital Advisory Group Ltd.

**John P. A. Budreski**

President and Chief Executive Officer,  
Orion Securities Inc. and  
Orion Financial Inc.

**Eric McFadden**

Managing Director  
Creststreet Capital Corporation

**David P. Smith**

Managing Partner  
Enterprise Management Capital Inc.

**Robert J. Toole**

Managing Director  
Creststreet Capital Corporation

### Officers of the General Partner

**Eric McFadden**

President and Chief Executive Officer

**Derren Newell**

Vice-President, Finance and  
Chief Financial Officer

**Erich Ossowski**

Vice- President, Windpower Development

**Arlene Mclean**

Secretary

### Legal Counsel

McCarthy Tétrault LLP  
Calgary, Alberta

### Auditors

Ernst & Young LLP  
Montreal, Quebec

### Toronto Office

Creststreet Kettles Hill Windpower LP  
Suite 1450, 70 University Avenue  
Toronto, Ontario M5J 2M4  
Tel: (416) 864-6330  
Toll Free: 1-866-864-6330  
Fax: (416) 862-8950

### Calgary Office

Creststreet Kettles Hill Windpower LP  
Suite 300, 805-10<sup>th</sup> Avenue S.W.,  
Calgary, Alberta T2R 0B4  
Tel: (403) 513-0777  
Toll Free: 1-877-513-0777  
Fax: (403) 265-4438

E-mail: [info@creststreet.com](mailto:info@creststreet.com)  
Website: [www.creststreet.com](http://www.creststreet.com)