



Creststreet Kettles Hill Windpower LP

Quarterly Report > Q2 2006

Management's Discussion and Analysis

August 15, 2006

Forward-Looking Statements

Except for the historical and present factual information, certain statements contained in this Management's Discussion & Analysis ("MD&A") constitute "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. The Creststreet Kettles Hill Windpower LP (the "Partnership") considers 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 as well as additional information are outlined in this MD&A.

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 the Partnership for the three and six-month periods ended June 30, 2006, and it should be read in conjunction with the Partnership's unaudited interim consolidated financial statements for the same periods, along with the MD&A and consolidated financial statements for the year ended December 31, 2005, and the first quarter ended March 31, 2006. 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 \$40.0 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 comprised of 35 interconnected Vestas V80 1.8 MW 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 138 kV transmission line.

We estimate that the capital cost to construct all 35 turbines and related infrastructure will be approximately \$110.0 million, which is being financed through a combination of the proceeds from the Partnership's IPO, investments by various Creststreet entities and a senior debt facility provided by a major Canadian financial institution. Please see the liquidity section of this MD&A for details on the financing of the project.

Management's Discussion and Analysis (cont'd)

In March 2006, Kettles Hill completed the construction and commissioning of the five Canadian Renewable Conservation Expense (the "CRCE Phase") test turbines at the Kettles Hill facility. It also completed construction and commission 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 test turbines expenses 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 prevailing market rates.

As the test period has now been completed, work to install and commission the remaining 30 wind turbines for the Infill Construction Phase has begun. Completion of this phase of the project has been delayed as Vestas has advised the Manager of additional equipment delivery delays. Vestas has agreed to deliver all of the Infill Construction Phase turbines by November 15, 2006. Based on its current schedule, the Manager expects that the project will be completed during the first quarter of 2007, approximately six months behind schedule. Kettles Hill will receive liquidated damages from Vestas as a result of the delays.

High activity levels in the Alberta construction market continued to increase construction costs in the first half of 2006, resulting in incurred and expected cost overruns. These cost overruns are anticipated to be substantially offset by design changes and the impact of the depreciation of the euro relative to the Canadian dollar on the cost of turbines. Kettles Hill and the Partnership continue to closely monitor the construction costs, and as at the date hereof, the project costs approximate the original budget. Readers are cautioned that currency savings cannot be realized until the payment of certain installments on the turbines have been made.

Based on the current construction schedule, it is anticipated that the ground and foundation work for the Infill Construction Phase will be completed in the third quarter of 2006. The erection of the towers is expected to occur during the fourth quarter of 2006. Installation of the turbines is also expected to begin in the fourth quarter of 2006 and is anticipated to be completed in the first quarter of 2007.

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 first six months of 2006, \$9.9 million was spent on the project.

Results of Operations

> Revenue

For the three months ended June 30, 2006, the Partnership generated revenue of \$289,000 (2005 – Nil) from the delivery of 6,434 megawatt hours ("MWh") of electricity which was 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 pool prices at the time of delivery.

For the six months ended June 30, 2006, the Partnership earned \$339,000 in revenue from the delivery of a total of 7,710 MWh of electricity (2005 – Nil).



> **Operating Costs**

For the three months ended June 30, 2006, the Partnership incurred operating costs of \$76,000 (2005 – Nil) and recorded an operating margin of 74% of revenue. The expenses related to the operation of the projects are primarily fixed costs such as warranty and maintenance fees, insurance, leases, property taxes, and power pool trading charges. Other operating costs for the second quarter included management fees of \$148,000 and administrative costs of \$114,000 (2005 – Nil).

For the six months ended June 30, 2006, the Partnership incurred operating costs of \$105,000 (2005 – Nil) and recorded an operating margin of 69% of revenue. Other operating costs for the six months ended June 30, 2006, included management fees of \$283,000 (2005 – Nil) and administrative costs of \$214,000 (2005 – Nil) related to the operation of the Partnership.

> **Amortization**

We reclassified the costs of construction in progress related to the CRCE Phase to plant and equipment and began amortizing these costs when the project commenced commercial operation of its CRCE Phase in the first quarter of 2006. We recorded amortization of plant and equipment of \$386,000 and \$514,000 for the three and six months ended June 30, 2006, respectively.

We also began amortizing deferred charges and pre-operating costs upon substantial completion of the CRCE Phase and recorded amortization of deferred charges and pre-operating costs of \$180,000 and \$241,000, for the three and six months ended June 30, 2006, respectively.

> **Interest and Gains and Losses on Derivatives**

Interest expense recorded in the second quarter and for the six months ended June 30, 2006, was incurred on the \$6.5 million subordinated promissory note investment made by the Creststreet Power & Income Fund LP (“CPIF”). These funds have been used by the Partnership to help fund the construction of the Kettles Hill facility.

Kettles Hill entered into option agreements to purchase euros, which were used to reduce foreign exchange rate exposure on future purchases of wind turbines. These option agreements 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 \$894,000 was capitalized to pre-operating cost. Prior to March 1, 2006, as Kettles Hill was in the pre-operation stage, the unrealized gains or losses on derivatives were capitalized to pre-operating cost. Subsequent to March 1, 2006, when Kettles Hill commenced commercial operation of its CRCE Phase turbines, the unrealized gains or losses on these agreements were recorded in the consolidated income statement. For the three and six-month periods ended June 30, 2006, the option agreements incurred \$68,000 of unrealized exchange loss and \$71,000 of unrealized exchange gain, respectively (2005 – Nil).

As at June 30, 2006, Kettles Hill held an option to purchase €7.0 million at an exercise price of \$1.4170 per euro for which it paid consideration of \$143,000. This option was exercised on July 31, 2006, prior to its expiry, resulting in settlement proceeds of \$161,000 being received by Kettles Hill in August.

> **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 \$1.030 million.

Management's Discussion and Analysis (cont'd)

Quarterly Financial Information

(In thousands, except per unit amounts)	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	Total
Revenue	\$ 50	\$ 289	\$ 339
Net earnings/(loss)	\$ (209)	\$ 427	\$ 218
Net earnings/(loss) per unit	\$ (0.05)	\$ 0.11	\$ 0.06

The CRCE Phase turbines at Kettles Hill began commercial production of electricity thereby generating revenue and incurring operating expenses in March 2006. The second quarter of 2006 reflected a full quarter of revenue and expenses from the initial five turbines, as discussed above.

The first quarter of 2006 reflected one month of revenue and operating expenses from the initial five turbines. Kettles Hill earned \$50,000 in electricity sales, and paid operating costs of \$29,000, management fees of \$135,000 and administrative fees of \$100,000. In addition, Kettles Hill earned \$19,000 in interest income on short-term investments, incurred \$40,000 of interest expense on promissory notes, and earned \$139,000 in unrealized foreign exchange gain on derivatives in the first quarter of 2006.

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.

Financial Condition

> Liquidity

The estimated capital cost of the Kettles Hill project is \$110.0 million. 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)	\$ 35.5 million
Subordinated notes funded by Creststreet Power & Income Fund LP	\$ 31.0 million
Senior debt facility (provided by a major Canadian financial institution)	\$ 42.5 million
Total financing	\$ 113.5 million

The additional financing received by Kettles Hill will be used to service accrued interest on the construction debt facilities.



On December 19, 2005, Kettles Hill announced a commitment by CPIF to invest up to \$31.0 million in subordinated notes to complete the financing requirements to fund the completion of the project and to fund any working capital deficiencies. As at June 30, 2006, \$6.5 million, was advanced by CPIF. On August 2, 2006, CPIF invested an additional \$6.5 million bringing the total investment to \$13.0 million. CPIF has indicated to the Partnership that upon closing of its \$30.0 million 8% subordinated convertible debenture offering in August, it will invest an additional \$7.9 million in subordinated notes, bringing its total investment to \$20.9 million. To increase its investment to the committed \$31.0 million from \$20.9 million, CPIF is required to get approval from its unitholders under securities regulations. CPIF has called a special meeting of its unitholders for September 6, 2006, to obtain this approval. If unitholder approval is obtained, CPIF will then invest in the additional \$10.1 million of subordinated promissory notes. If the CPIF unitholders do not approve this investment, Kettles Hill will then be required to raise additional financing on its own. The terms of these subordinated notes are described in Note 9 to the unaudited interim consolidated financial statements for June 30, 2006.

On December 19, 2005, Kettles Hill also announced the closing of a construction loan facility with a major Canadian financial institution totalling \$42.5 million to finance its Infill Construction Phase. The terms of this loan are described in Note 9 to the unaudited interim consolidated financial statements for June 30, 2006. Subsequent to June 30, 2006, \$8.75 million of Tranche A of this construction loan 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 be amortized 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 \$2.0 million per year until March 31, 2009.

As at June 30, 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 6.5%. If Kettles Hill is not eligible for WPPI or if the program ceases to exist, the average effective interest rate on this loan will be 7.63%.

Cash held in escrow decreased to \$117,000 at June 30, 2006, from \$2.904 million at December 31, 2005, due to the funding of construction costs.

> **Contractual Obligations**

Kettles Hill has entered into a turbine supply agreement with Vestas to purchase up to 35 wind turbines. The turbine supply agreement payments are denominated in Canadian dollars and euros.

Kettles Hill has also entered into a Warranty, Maintenance and Service ("WMS") agreement with 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 covers power curve performance (the conversion of wind speed to power) and turbine 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 contract is for a five-year period from the date the turbines come into service. As at June 30, 2006, the total remaining commitment to Vestas to complete the CRCE Phase and WMS agreement was \$1.1 million.

Management's Discussion and Analysis (cont'd)

In April 2006, Kettles Hill signed a contract for the sale of 30 gigawatt hours ("GWh") of renewable energy certificates from 2006 production to Baseline Emissions Management Inc. ("Baseline"). Baseline has an option to purchase an additional 20 GWh of renewable energy certificates from 2007 production. Additionally, in June 2006, Kettles Hill entered into an agreement with the Government of Canada for the sale of emissions reductions from 2007 production.

> Related Party Transactions

Creststreet Kettles Hill Windpower General Partner Limited (the "General Partner") is reimbursed for reasonable costs it incurs by acting as registrar and transfer agent and in attending to the administration of the Partnership.

The Manager is entitled to management fees as well as a reimbursement of its operating expenses incurred in providing the services under the Management Agreement.

Kettles Hill has entered a Financial Administration Agreement with Creststreet Capital Corporation ("CCC") to maintain the minute books and records of the company and to provide it with other general accounting and cash management services.

Kettles Hill has entered into a Consulting Agreement with a shareholder, Benign Energy Canada Inc. ("BECI"). The Consulting Agreement's term ends on the date of substantial completion of the Infill Construction Phase. BECI will assist with supervision of the construction and administration of the Engineering, Procurements and Construction Services agreement and Turbine Supply Agreement.

Kettles Hill has also entered into a Management Services Agreement with BECI to assist in the day-to-day operations of the facility, which has an initial term of five years that renews automatically unless BECI provides one-year's prior written notice of its intention not to renew.

For the three and six-month periods ended June 30, 2006, the fees charged by CCC, the Manager and General Partner in accordance with the Management Services Agreement and Financial Services Agreement amounted to \$133,000 and \$266,000 (2005 – Nil), respectively.

For the three and six-month periods ended June 30, 2006, Creststreet Holdings Ltd. ("CHL"), a related party with common management, was paid \$36,000 and \$101,000, respectively, for the reimbursement of costs it paid directly on behalf of the Partnership (2005 – Nil).

For the three and six-month periods ended June 30, 2006, fees charged by BECI in accordance with the Consulting Service Agreement and Management Services Agreement, including reimbursement for out-of-pocket expenses amounted to \$140,000 and \$557,000 (2005 – Nil), respectively.



The following amounts were paid to related parties:

	Three months ended		Six months ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
BECI	\$ 140	\$ -	\$ 557	\$ -
Manager	128	-	257	-
CHL	36	-	101	-
CCC	5	-	9	-
	\$ 309	\$ -	\$ 924	\$ -

Change in Partners' Capital and Deficit

Partners' capital decreased to \$28,694 at June 30, 2006, from \$36,624 at December 31, 2005, as a result of renunciations of resource expenditure deductions for income tax purposes.

Critical Accounting Estimates

Plant and equipment is amortized based on a useful life of 20 years, in accordance with the design life of the turbines.

At the beginning of the second quarter of 2006, the Partnership reviewed the assumptions that are used in the asset retirement obligation and increased the credit-adjusted, risk-free rate to 11% from 10%.

The total undiscounted amount of estimated cash flows required to settle the obligation was \$189,000 at June 30, 2006 (2005 – Nil).

Asset retirement obligations are primarily associated with certain closure, reclamation and restoration costs related to retirement of the wind farm properties. Most of these obligations are not expected to be paid for 20 years and will be funded from general company resources at that time.

Outlook

The Manager continues to view the independent energy forecast provided in the Partnership's initial public offering prospectus as reasonable, despite the strengthening Alberta power market prices. According to Alberta Watt Exchange Ltd., the forward settlement price of Alberta baseload power as at June 30, 2006, averaged \$63.62 per MWh for the third and fourth quarters of 2006 and \$63.44 per MWh for the 2007 calendar year.

Risk Factors

> Foreign Currency Risk

Kettles Hill has entered into the Kettles Hill Turbine Supply Agreement to purchase the 30 wind turbines required to complete the Infill Construction Phase. The Turbine Supply Agreement has fixed payment terms which are denominated in Canadian dollars and euros. As the funding for the Kettles Hill facility is denominated in Canadian dollars, a portion of the cost of the Kettles Hill facility is exposed to fluctuations in the Canadian dollar relative to the euro. Kettles Hill has floating exchange rate exposure on the remaining €24 million of payments it will make. Significant fluctuations in the floating Canadian dollar/euro exchange rate will impact the cost of building the Kettles Hill facility.

Management's Discussion and Analysis (cont'd)

> **Failure of CPIF to Obtain Unitholder Approval for Further Investment in Kettles Hill**

In the event that CPIF's unitholders do not approve the further \$10.1 million investment in subordinated notes at the special meeting of CPIF unitholders, Kettles Hill will need to obtain another source of financing in order to be able to complete the construction of the Kettles Hill facility. There can be no assurance that such financing will be available on satisfactory terms and conditions. Failure to obtain approval would also result in the non-satisfaction of a condition precedent of the Kettles Hill Credit Agreement, which could result in the Kettles Hill Senior Debt Facility being unavailable to Kettles Hill to fund the completion of the Kettles Hill Facility.

> **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. Further information regarding the expanded WPPI program, including the eligibility requirements, is expected this fall. In the event that the Kettles Hill facility does not qualify for WPPI under the expanded WPPI program, funding for the expanded WPPI program is not available or the expanded WPPI program is not implemented in the manner contemplated by the 2005 budget or at all, the revenue and income of the Partnership may be materially and adversely affected.

Readers are cautioned that additional risk factors are discussed in the Partnership's MD&A for the year ended December 31, 2005, the Partnership's MD&A for the first quarter of 2006, as well as the Partnership's annual information form, which are filed on SEDAR and can be accessed at www.sedar.com.

**Consolidated Balance Sheets**

As at June 30, 2006 and December 31, 2005

(Unaudited) (In thousands)	As at June 30, 2006	As at December 31, 2005
Assets		
Current Assets		
Cash	\$ 535	\$ 507
Cash held in escrow (Note 3)	117	2,904
Accounts receivable	204	1,079
Prepaid expense	89	59
	945	4,549
Derivatives (Note 4)	147	29
Deferred charges and pre-operating costs (Note 5)	3,022	2,966
Construction in progress (Note 6)	13,934	38,702
Plant and equipment (Note 7)	30,582	–
Goodwill	2,014	2,014
	\$ 50,644	\$ 48,260
Liabilities		
Current Liabilities		
Accounts payable and accrued liabilities	1,814	5,696
Deferred revenue	23	–
Due to related parties (Note 8)	962	147
	2,799	5,843
Subordinated note payable (Note 9)	7,330	900
Asset retirement obligation (Note 10)	29	–
Future income tax liability	7,776	1,151
Non-controlling interest	4,472	4,416
	22,406	12,310
Partners' capital	28,694	36,624
Deficit	(456)	(674)
	\$ 50,644	\$ 48,260

Commitments (Note 11)

See accompanying notes to interim consolidated financial statements.

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

Eric McFadden
Director

John Budreski
Director

Consolidated Income Statements

For the three and six months ended June 30, 2006 and 2005

(Unaudited) (In thousands, except per unit data)	Three months ended		Six months ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
		(Note 1)		(Note 1)
Revenue				
Electricity sales	\$ 289	\$ —	\$ 339	\$ —
Total revenue	289	—	339	—
Expenses				
Operating costs	76	—	105	—
Management fees (Note 8)	148	—	283	—
Administrative fees	114	—	214	—
Total expenses	338	—	602	—
Loss before the undernoted	(49)	—	(263)	—
Amortization of plant and equipment (Note 7)	386	—	514	—
Amortization of deferred charges and pre-operating costs (Note 5)	180	—	241	—
Unrealized foreign exchange loss (gain) on derivatives	68	—	(71)	—
Interest expense (investment income), net	138	—	159	—
Loss before taxes and non-controlling interest	(821)	—	(1,106)	—
Future income tax recovery	1,323	—	1,381	—
Non-controlling interest	(75)	—	(57)	—
Net earnings	427	—	218	—
Deficit, beginning of period	(883)	—	(674)	—
Deficit, end of period	\$ (456)	\$ —	\$ (456)	\$ —
Net earnings per unit – basic and diluted	\$ 0.11	\$ —	\$ 0.06	\$ —
Weighted average number of units	4,000	—	4,000	—

See accompanying notes to interim consolidated financial statements.



Consolidated Statements of Partners' Capital

For the three and six months ended June 30, 2006 and 2005

(Unaudited) (In thousands)	Three months ended		Six months ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
		(Note 1)		(Note 1)
Partners' capital – beginning of period	\$ 28,677	\$ –	\$ 36,624	\$ –
Equity component of subordinated note payable	17	–	76	–
Future income tax resulting from renunciation	–	–	(8,006)	–
Partners' capital – end of period	\$ 28,694	\$ –	\$ 28,694	\$ –

See accompanying notes to interim consolidated financial statements.

Consolidated Statements of Cash Flows

For the three and six months ended June 30, 2006 and 2005

(Unaudited) (In thousands)	Three months ended		Six months ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
		(Note 1)		(Note 1)
Cash flows from operating activities				
Net earnings	\$ 427	\$ —	\$ 218	\$ —
Add (deduct) items not affecting cash:				
Future income tax recovery	(1,323)	—	(1,381)	—
Amortization of plant and equipment	386	—	514	—
Amortization of deferred charges and pre-operating costs	180	—	241	—
Accretion of interest expense	8	—	8	—
Unrealized foreign exchange loss (gain) on derivatives	68	—	(71)	—
Non-controlling interest	75	—	57	—
	(179)	—	(414)	—
Non-cash operating working capital				
Decrease in accounts receivable	1,239	—	875	—
(Increase) decrease in prepaid expense	2	—	(30)	—
Decrease in accounts payable and accrued liabilities	(88)	—	(116)	—
Increase in deferred revenue	23	—	23	—
Increase in amounts due to related parties	338	—	815	—
	1,335	—	1,153	—
Cash flows from financing activities				
Issue of subordinated notes by subsidiary to CPIF	1,500	—	6,500	—
Increase in financing fees	(195)	—	(256)	—
	1,305	—	6,244	—
Cash flows from investing activities				
Decrease in cash held in escrow	887	—	2,787	—
Additions to plant and equipment	(3,467)	—	(9,880)	—
(Increase) decrease in deferred charges and pre-operating costs	26	—	(276)	—
	(2,554)	—	(7,369)	—
Net increase in cash	86	—	28	—
Cash and cash equivalents, beginning of period	449	—	507	—
Cash and cash equivalents, end of period	\$ 535	\$ —	\$ 535	\$ —
Supplemental cash information				
Interest paid	\$ —	\$ —	\$ —	\$ —

See accompanying notes to interim consolidated financial statements.



Notes to Interim Consolidated Financial Statements

Three and six months ended June 30, 2006 and 2005

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

1. Creststreet Kettles Hill Windpower LP

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 will construct and then operate a wind energy project to generate electricity for sale to the Alberta power market. The Partnership completed its initial public offering on July 11, 2005, 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 ("CRCE") tax rules. This test period was completed in July 2006. Prior to March 2006, the Partnership was considered to be in the development stage.

2. Summary of Significant Accounting Policies

The interim consolidated financial statements have been prepared by the Partnership in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of the financial data is based on accounting policies and practices consistent with those used in the preparation of the audited annual consolidated statements. The accompanying unaudited consolidated financial statements have been prepared in accordance with Canadian GAAP for interim financial statements and, accordingly, certain information and footnote disclosure normally included in annual financial statements have been condensed or omitted. These financial statements include the accounts of the Partnership and its subsidiary, Kettles Hill. All significant transactions and balances between the Partnership and Kettles Hill have been eliminated on consolidation. In management's opinion, the accompanying unaudited financial statements include all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position of the Partnership as at June 30, 2006, and December 31, 2005, and the consolidated results of operation for the three and six-month periods ended June 30, 2006. The results of operations of any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year. The Partnership's earnings are subject to seasonal fluctuations with the highest level of revenue during the winter months (generally, the first and the fourth quarters).

Effective January 1, 2006, Kettles Hill adopted accounting requirements of the Canadian Institute of Chartered Accountants as issued in Section 3110 "Accounting for Asset Retirement Obligations," which 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 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 is 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 had recorded asset retirement obligations primarily associated with certain closure, reclamation and restoration costs for their wind energy turbines of \$28,000 as at June 30, 2006.

Notes to Interim Consolidated Financial Statements (cont'd)

3. Cash Held in Escrow

Kettles Hill entered into an escrow agreement dated June 30, 2005, in connection with its obligation of \$4.801 million to Vestas-Canadian Wind Technology Inc. ("Vestas") for CRCE Phase turbines. The amount of \$3.201 million was released when the CRCE Phase turbines were delivered, and the balance will be released once the turbines have been commissioned and the required performance tests have been completed. As at June 30, 2006, \$4.684 million was released from escrow to pay Kettles Hill's obligation to Vestas for CRCE Phase turbines.

4. Derivatives

As at June 30, 2006, Kettles Hill held an option to purchase €7.0 million at an exercise price of \$1.4170 per euro for which it paid consideration of \$143,000. This option was exercised on July 31, 2006, prior to its expiry resulting in settlement proceeds of \$161,000 being received by Kettles Hill in August. For the three months and six-month periods ended June 30, 2006, the option agreement incurred \$68,000 of unrealized exchange loss and \$71,000 of unrealized exchange gain, respectively (2005 – Nil). The \$68,000 reduction of unrealized gain in the second quarter reflects the four option agreements that expired in the second quarter.

The option agreements are used to reduce foreign exchange rate exposure on future 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 costs of \$894,000 paid on entering the agreements were capitalized to pre-operating costs. Prior to March 1, 2006, as Kettles Hill was in the pre-operation stage, the unrealized gains or losses on derivatives were capitalized to pre-operating costs. Subsequent to March 1, 2006, when Kettles Hill commenced commercial operation of its CRCE phase turbines, the unrealized gains or losses on these agreements were recorded in the Consolidated Income Statements.

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

5. Deferred Charges 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 June 30, 2006, the fees and expenses charged to enter into this facility totalled \$1.499 million. Cumulative amortization of the deferred financing costs amounted to \$158,000, of which \$77,000 and \$101,000 were expensed in the three months and six-month periods ended June 30, 2006, respectively (2005 – Nil).

As at June 30, 2006, Kettles Hill had capitalized \$1.821 million of pre-operating costs, which is being amortized over a five-year period starting at the completion of the CRCE Phase. Amortization of the pre-operating costs amounted to \$103,000 and \$140,000, respectively, for the three and six-month periods ended June 30, 2006 (2005 – Nil).



6. Construction in Progress

	June 30, 2006	December 31, 2005
CRCE Phase		
Construction in progress, beginning of period	\$ 25,002	\$ –
Additions	6,066	25,002
	31,068	25,002
Amount transferred to plant and equipment (i)	(31,068)	–
	–	25,002
Infill Phase		
Construction in progress, beginning of period	13,700	–
Additions	234	13,700
	13,934	13,700
Construction in progress, end of period	\$ 13,934	\$ 38,702

(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.

7. Plant and Equipment

	June 30, 2006	December 31, 2005
Kettles Hill (i)	\$ 31,068	\$ –
Less: accumulated depreciation	(514)	–
Asset retirement obligation (ii)	28	–
Total	\$ 30,582	\$ –

(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.

(ii) As at June 30, 2006, the asset retirement obligation amounted to \$28,000, which is primarily associated with certain closure, reclamation and restoration costs for the wind energy turbines.

8. Related Party Transactions

In 2005, Kettles Hill has entered into a subordinated note with Creststreet Windpower Development LP (“CWDLP”) for \$900,000 to finance pre-development costs. Interest is charged at a rate of 10% per annum. As at June 30, 2006, the Partnership had incurred \$109,000 of interest, of which \$79,000 was capitalized during the construction period. For the three and six-month periods ended June 30, 2006, the Partnership incurred \$22,000 and \$30,000 of interest expense (2005 – Nil), respectively.

On December 19, 2005, Creststreet Power & Income Fund LP (“CPIF”), a related party with common management, committed to invest in a subordinated note of Kettles Hill to help complete the funding requirements of the project. CPIF committed to invest up to \$31.0 million in subordinated notes. As at June 30, 2006, \$6.5 million had been advanced with interest charged at a rate of 8.25% per annum, and the Partnership had incurred \$179,000 of interest, of which \$24,000 was capitalized during the construction period. For the three and six-month periods ended June 30, 2006, the Partnership incurred \$123,000 and \$155,000 of interest expense (2005 – Nil), respectively.

For the three and six month periods ended June 30, 2006, the fees charged by Creststreet Capital Corporation (“CCC”), Creststreet Kettles Hill Windpower Management Limited (the “Manager”) and Creststreet Kettles Hill Windpower General Partner Limited (the “General Partner”) in accordance with the management agreement and financial services agreement amounted to \$133,000 and \$266,000 (2005 – Nil), respectively.

Notes to Interim Consolidated Financial Statements (cont'd)

For the three and six-month periods ended June 30, 2006, Creststreet Holdings Ltd. ("CHL"), a related party with common management, was paid \$36,000 and \$101,000, respectively, as reimbursement for costs it paid directly on behalf of the Partnership (2005 – Nil).

For the three and six-month periods ended June 30, 2006, fees charged by Benign Energy Canada Inc. ("BECI") in accordance with the Consulting Agreement and Management Services Agreement, including reimbursement for out-of-pocket expenses, amounted to \$140,000 and \$557,000 (2005 – Nil), respectively.

The amounts due to related parties are as follows:

	As at June 30, 2006	As at December 31, 2005
Due to BECI	\$ 467	\$ –
Due to CHL	33	–
Due to CCC	133	43
Due to CWDLP	149	104
Due to CPIFLP	180	–
	\$ 962	\$ 147

The amounts paid to related parties are as follows:

	Three months ended		Six months ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
BECI	\$ 140	\$ –	\$ 557	\$ –
Manager	129	–	257	–
CHL	36	–	101	–
CCC	4	–	9	–
	\$ 309	\$ –	\$ 924	\$ –

9. Credit Facility

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

In addition, Kettles Hill closed a commitment by CPIF to invest up to \$31.0 million in subordinated notes to complete the funding requirements of the project. As at June 30, 2006, CPIF had advanced \$6.5 million to Kettles Hill. Half of the subordinated notes are convertible into shares in Kettles Hill at a price of \$1.70 per share. The Partnership determined that the fair value of the conversion option was \$0.04 per share, based on the Black-Scholes model, and included \$76,000 in the Consolidated Statements of Partners' Capital. The liability portion of the subordinated notes is accreted such that the liability at maturity will equal the gross proceeds less conversions. For the period ended June 30, 2006, \$7,000 of accretion expense had been included in the Consolidated Income Statements.

Subsequent to June 30, 2006, the terms of these notes were modified so that the interest on these notes will not be payable until the earlier of March 31, 2007, or 60 days after completion of the Infill Phase, however, it will be accrued on a monthly basis and the notes will no longer be convertible into shares of Kettles Hill.



These notes are due on October 31, 2009, unless CPIF acquires more than 50% of Kettles Hill in which case the notes will mature October 31, 2026. If Kettles Hill is acquired by a third party other than CPIF, CPIF has a right to put all or a portion of these subordinated notes to the Partnership, and the Partnership shall be required 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.

On August 2, 2006, CPIF invested an additional \$6.5 million in Kettles Hill subordinated notes, which contained the new terms and conditions described above and bear interest at 9.25%.

Facility	Available credit	Amount advanced	Interest	Maturity
Subordinated notes – CPIF	\$ 31,000	\$ 6,500	8.25%	October 31, 2009
Credit facility				
Tranche A	22,500	–	To be determined one day prior to advances	December 31, 2008
Tranche B	20,000	–	To be determined one day prior to advances	December 31, 2016
Total	\$ 73,500	\$ 6,500		

The credit facilities contain customary representations, warranties and covenants (including financial covenants and restriction on incurring additional indebtedness). Collateral for the credit facilities is provided by a first-priority security interest in the assets of Kettles Hill.

The subordinated notes have been advanced in four pieces which aggregate to \$6.5 million, with \$5.0 million being advanced in the first quarter of 2006 and a further \$1.5 million being advanced in the second quarter of 2006.

The entire amount of Tranche B of the credit facility will be advanced as a construction loan after completion of the 120-day test period of the CRCE Phase (the “First Advance Date”). Tranche A will be advanced as a construction loan after the First Advance Date and before the completion of construction of the Infill Phase. 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.

Subsequent to June 30, 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 be required to be amortized consistent with the rest of the loan. If the WPPI contribution is not received, this \$8.75 million advance’s interest rate will then be calculated using the 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 repayments of \$2.0 million per year until March 31, 2009.

Repayment of the credit facility is interest only until maturity except as described above. Interest for both Tranche A and B will be 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

Notes to Interim Consolidated Financial Statements (cont'd)

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. 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.

The credit spread is:

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

As at June 30, 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 6.5%. If Kettles Hill is not eligible for WPPI or if the program ceases to exist, the average effective interest rate on this loan will be 7.63%.

The payment of the principal of, and interest on, 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.

10. 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.

	June 30, 2006	December 31, 2005
Asset retirement obligation, beginning of period	\$ -	\$ -
Liabilities incurred	28	-
Accretion expense	1	-
Asset retirement obligation, end of period	\$ 29	\$ -

The total amount of estimated discounted cash flows required to settle the obligations was \$29,000 (2005 – Nil), which was discounted using a credit-adjusted, risk-free rate and an inflation rate of 2%.

At the beginning of the second quarter, the Partnership reviewed the assumptions that are used in the asset retirement obligation and increased the credit-adjusted, risk-free rate to 11% from 10%.

The total undiscounted amount of estimated cash flows required to settle the obligation was \$189,000 at June 30, 2006 (2005 – Nil).

Asset retirement obligations are primarily associated with certain closure, reclamation and restoration costs related to retirement of the wind farm properties. Most of these obligations are not expected to be paid for 20 years and will be funded from general company resources at that time.



11. Commitments

Kettles Hill has entered into a turbine supply agreement with Vestas-Canadian Wind Technology (“Vestas”), to purchase up to 35 wind turbines. The turbine supply agreement payments are denominated in Canadian dollars and euros. Kettles Hill had one foreign currency option in place to reduce the foreign currency exposure at June 30, 2006.

Kettles Hill has also entered into a Warranty, Maintenance and Service (“WMS”) agreement with 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 contract is for a five-year period from the date the turbines come into service. As at June 30, 2006, the total remaining commitment to Vestas to complete the CRCE Phase and WMS agreement was \$1.078 million.

In April 2006, Kettles Hill signed a contract for the sale of 30 gigawatt hours (“GWh”) of renewable energy certificates from 2006 production to Baseline Emissions Management Inc. (“Baseline”). Baseline has an option to purchase a further 20 GWh of renewable energy certificates from 2007 production. Additionally, in June 2006, Kettles Hill entered into an agreement with the federal government for the sale of emissions reductions from 2007 production.

12. Economic Dependence

For the period ended June 30, 2006, the Partnership was dependent on Alberta Electric System Operator for 100% of its revenue from electricity sales.

13. Financial Instruments

At June 30, 2006, the carrying amount of cash, cash held in escrow, accounts receivable, accounts payable and accrued liabilities and due to related parties approximated fair value due to their short-term nature.

At June 30, 2006, the carrying amount of the subordinated notes payable approximated fair value due to the short period of 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 until amounts are advanced under the credit facilities.

14. Subsequent Event

On July 31, 2006, the Partnership exercised the option agreement to purchase €7.0 million, generating \$161,000 in settlement proceeds.

On August 2, 2006, CPIF invested another \$6.5 million into Kettles Hill subordinated notes as further described in Note 9.

On August 4, 2006, Kettles Hill made a progress payment as required under the turbine supply agreement with Vestas.

15. Reclassification

Certain amounts have been reclassified on the comparative financial statements to conform to the current period’s presentation.

Creststreet Kettles Hill Windpower LP

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