



An **ATCO** Company

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

**FOR THE THREE MONTHS ENDED
MARCH 31, 2004**

CU INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("MD&A")

The following discussion and analysis of financial condition and results of operations of CU Inc. (the "Corporation") should be read in conjunction with the Corporation's unaudited comparative interim financial statements for the three months ended March 31, 2004, and the audited comparative financial statements and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2003 ("2003 MD&A"). Information contained in the 2003 MD&A that is not discussed in this document remains substantially unchanged. Additional information relating to the Corporation, including the Corporation's Annual Information Form, is available on SEDAR at www.sedar.com.

FORWARD-LOOKING INFORMATION

Certain statements contained in this MD&A constitute forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "anticipate", "plan", "estimate", "expect", "may", "will", "intend", "should", and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Corporation believes that the expectations reflected in the forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements should not be unduly relied upon.

In particular, this MD&A contains forward-looking statements pertaining to purchase obligations, planned capital expenditures, anticipated completion dates and construction costs of major projects, and the impact of changes in government regulation. The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of regulatory decisions, competitive factors in the industries in which the Corporation operates, prevailing economic conditions, and other factors, many of which are beyond the control of the Corporation.

BUSINESS OF THE CORPORATION

The Corporation's financial statements are consolidated from two segments: natural gas and electric and power generation (see Note 6 to the comparative financial statements). Transactions between segments are eliminated in all reporting of the Corporation's consolidated financial information.

RESULTS OF OPERATIONS

The principal factors that caused variations in quarterly revenues were:

- fluctuations in temperatures (refer to the Natural Gas and Electric section);
- fluctuations in natural gas and electricity prices (refer to the Natural Gas and Electric section); and
- timing of rate decisions (refer to the Natural Gas and Electric section).

The principal factors that caused variations in quarterly earnings were:

- fluctuations in temperatures (refer to the Natural Gas and Electric section); and
- timing of rate decisions (refer to the Natural Gas and Electric section).

Consolidated Operations

Revenues and earnings attributable to Class A non-voting shares ("Class A shares") and Class B common shares ("Class B shares") were as follows:

	For the Three Months Ended March 31	
	2004	2003
	(\$ Millions) (unaudited)	
Revenues.....	960.0	1,099.2
Earnings attributable to Class A shares and Class B shares (1) (2) (3).....	63.8	62.7

Notes:

- (1) *There were no discontinued operations or extraordinary items during these periods.*
- (2) *Due to the seasonal nature of the Corporation's operations and the timing of rate decisions, earnings for any quarter are not necessarily indicative of operations on an annual basis.*
- (3) *2003 earnings attributable to Class A shares and Class B shares have been restated for a retroactive change in method of accounting for asset retirement obligations.*
- (4) *As all Class A shares and Class B shares of the Corporation are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.*
- (5) *The above data has been prepared in accordance with Canadian generally accepted accounting principles and the reporting currency is the Canadian dollar.*

Revenues for the three months ended March 31, 2004, decreased by \$139.2 million to \$960.0 million, primarily due to:

- the lower prices of natural gas and electricity purchased for customers on a “no-margin” basis by ATCO Gas and ATCO Electric;
- negative impact of the Alberta Energy and Utilities Board (“AEUB”) decision respecting the 2003/2004 general tariff application for ATCO Electric which decreased ATCO Electric’s rate of return on common equity to 9.4% and the common equity ratio to 32% for transmission operations and 35% for distribution operations. These reductions in the common equity ratios reduced the common equity that ATCO Electric is allowed to earn a return on by \$83.0 million (“ATCO Electric Decision”);
- negative impact of the AEUB decision regarding the 2003/2004 general rate application for ATCO Pipelines which decreased ATCO Pipelines’ rate of return on common equity to 9.5% and the common equity ratio to 43.5%. This reduction in the common equity ratio reduced the common equity that ATCO Pipelines is allowed to earn a return on by \$10.6 million (“ATCO Pipelines Decision”); and
- warmer temperatures in ATCO Gas for the three months ended March 31, 2004, which were 1.0% warmer than normal, compared to 7.0% colder than normal for the corresponding period in 2003.

Earnings attributable to Class A shares and Class B shares for the three months ended March 31, 2004, increased by \$1.1 million to \$63.8 million, primarily due to:

- moderately positive impact of the AEUB decision respecting the 2003/2004 general rate application for ATCO Gas that increased ATCO Gas’ rate of return on common equity to 9.5% (“ATCO Gas Decision”);
- lower Alberta income tax rates; and
- stronger operational results in Alberta Power (2000).

This increase was partially offset by:

- negative impacts of the ATCO Electric Decision and the ATCO Pipelines Decision;
- warmer temperatures in ATCO Gas.

Operating expenses (consisting of natural gas supply, purchased power, operation and maintenance, selling and administrative and franchise fee costs) for the three months ended March 31, 2004, decreased by \$142.6 million to \$758.4 million, primarily due to:

- lower natural gas supply costs and lower purchased power costs.

This decrease was partially offset by:

- higher selling and administrative expenses associated with the impact of the ATCO Gas Decision.

Depreciation and amortization expenses for the three months ended March 31, 2004, increased by \$3.7 million to \$59.4 million, primarily due to:

- capital additions in 2004 and 2003.

Interest expense for the three months ended March 31, 2004, increased by \$0.8 million to \$36.9 million, primarily due to:

- interest expense associated with the issue in January 2004 of \$180.0 million of 5.432% Debentures.

Interest and other income for the three months ended March 31, 2004, increased by \$0.3 million to \$1.6 million, primarily due to:

- increased interest income on higher cash balances.

This increase was partially offset by:

- lower rates of interest.

Income taxes for the three months ended March 31, 2004, decreased by \$1.9 million to \$39.6 million, primarily due to:

- lower income tax rates.

Segmented revenues and earnings attributable to Class A shares and Class B shares for the three months ended March 31, 2004, were as follows:

Segment	For the Three Months Ended March 31			
	Revenues		Earnings	
	2004	2003	2004	2003
	(\$ Millions) (unaudited)			
Natural Gas and Electric	884.1	1,022.7	49.9	49.5
Power Generation (1).....	76.9	77.9	13.6	13.2
Corporate and Other	-	-	0.3	-
Intersegment eliminations.....	(1.0)	(1.4)	-	-
Total.....	960.0	1,099.2	63.8	62.7

Notes:

(1) 2003 earnings have been restated for a retroactive change in method of accounting for asset retirement obligations.

Natural Gas and Electric

Revenues from natural gas and electric operations for the three months ended March 31, 2004, decreased by \$138.6 million to \$884.1 million, primarily due to:

- lower prices of natural gas and electricity purchased for customers on a “no-margin” basis;
- negative impact of the ATCO Electric Decision;
- negative impact of the ATCO Pipelines Decision and lower natural gas volumes purchased for ATCO Pipelines’ customers as a result of customers moving from sales service to transportation service contracts; and
- warmer temperatures in ATCO Gas for the three months ended March 31, 2004, which were 1.0% warmer than normal, compared to 7.0% colder than normal for the corresponding period in 2003.

This decrease was partially offset by:

- customer additions in ATCO Gas; and
- moderately positive impact of the ATCO Gas Decision.

Earnings for the three months ended March 31, 2004, increased by \$0.4 million to \$49.9 million, primarily due to:

- increased earnings related to ATCO Gas' customer additions; and
- moderately positive impact of the ATCO Gas Decision.

This increase was partially offset by:

- warmer temperatures in ATCO Gas; and
- negative impact of the ATCO Electric Decision and the ATCO Pipelines Decision.

ATCO Gas and ATCO Pipelines have been working together to confirm the accuracy of the historical transportation imbalances related to ATCO Gas' deferred gas cost account balance. Upon completion of this process, an application may be made to the AEUB to address any required adjustments to the deferred gas cost account.

Power Generation

Revenues from the power generation operations for the three months ended March 31, 2004, decreased by \$1.0 million to \$76.9 million, primarily due to:

- the expiry of the contract to operate the H.R. Milner generating plant on behalf of the Alberta Balancing Pool in January 2004.

This decrease was partially offset by:

- improved operating results.

Earnings for the three months ended March 31, 2004, increased by \$0.4 million to \$13.6 million, primarily due to:

- improved operating results.

At March 31, 2004, the Corporation had recorded a balance of \$51.4 million of deferred availability incentives, an increase of \$8.1 million from December 31, 2003, and an increase of \$4.3 million from March 31, 2003. During the three months ended March 31, 2004, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.9 million to \$1.9 million.

Transfer of Retail Energy Supply Functions

On May 4, 2004, ATCO Gas, ATCO Electric and Direct Energy Marketing Limited, a subsidiary of Centrica plc, closed the transfer of the retail energy supply businesses of ATCO Gas and ATCO Electric to Direct Energy Marketing Limited and one of its affiliates (collectively "DEML"). The transaction was previously announced in December 2002. Amendments to the previously announced transaction, which occurred primarily as a result of legislative amendments and regulatory changes in 2003, include proceeds of \$90 million (reduced from the originally announced \$128 million), of which \$45 million was paid at closing, with the remainder to be paid 12 months following closing.

Under the various transaction agreements, ATCO Gas and ATCO Electric have transferred to DEML certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions.

If DEML fails to perform all or part of the transferred functions, ATCO Gas and ATCO Electric will be required under existing legislation to perform such functions in the interim until DEML is able to perform such functions. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the agreements will terminate and the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and/or ATCO Electric. In certain circumstances, if DEML is restrained or prohibited from carrying out the transferred functions, all functions will revert to ATCO Gas and ATCO Electric and a portion of the purchase price will be refunded to DEML, depending upon the timing of any such reversion.

Centrica plc, DEML's parent, has provided a \$300 million guarantee supported by a \$235 million letter of credit in respect of DEML's obligations to ATCO Gas, ATCO Electric and ATCO I-Tek Business Services Ltd. in respect of the ongoing relationships contemplated under the transaction agreements. The Centrica guarantee and letter of credit include limits for certain categories of claims, which limits cease to apply if the agreements are terminated. If the amount available to be drawn under the letter of credit at any time falls below \$200 million, the agreements with

DEML will terminate and the functions will revert to ATCO Gas and ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and ATCO Electric.

Canadian Utilities has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek Business Services Ltd.'s payment and indemnity obligations in respect of the ongoing relationships contemplated under the transaction agreements.

On May 4, 2004, DEML commenced supplying natural gas and electricity at regulated rates to residential, farm and small business customers in the ATCO Gas and ATCO Electric service areas and billing customers for their natural gas and electricity service. Consequently, the Corporation's revenues and natural gas supply and purchased power costs in subsequent periods will be reduced accordingly. There will be no impact on earnings resulting from the discontinuance of these functions as natural gas and electricity have historically been sold to customers on a "no-margin" basis. Current employee levels of ATCO Gas and ATCO Electric are not expected to materially change as a result of this transaction. ATCO Gas and ATCO Electric continue to own and operate the natural gas and electricity distribution systems used to deliver energy.

ATCO Gas and ATCO Electric have also agreed not to compete in the regulated and unregulated retail energy business in Alberta for a period of ten years.

In December 2003, the AEUB issued decisions approving the transfer of the retail operations of ATCO Gas and ATCO Electric to DEML. The City of Calgary has filed leave to appeal the AEUB decision, including the allocation of proceeds to ATCO Gas and ATCO Electric. The City of Calgary's application for leave to appeal is scheduled to be heard on June 8, 2004.

REGULATORY MATTERS

Regulated operations are conducted by ATCO Electric, the ATCO Gas and ATCO Pipelines divisions of ATCO Gas and Pipelines Ltd., CU Water, and the generating plants of Alberta Power (2000), all of which are wholly owned subsidiaries of the Corporation.

In December 2003, the AEUB issued a decision approving the implementation of the "One Bill Model" no later than April 1, 2004. The One Bill Model is designed to ensure that customers who choose to purchase their natural gas requirements from a retailer will receive only one bill for natural gas service. Previously, customers would receive a bill from the retailer for the purchase of the commodity and a separate bill from ATCO Gas for the delivery service. ATCO Gas has now completed implementation of this process.

In April 2003, the AEUB determined that it would proceed with a generic cost of capital hearing to focus on the possibility of establishing a standardized approach to determine the rate of return on equity and capital structure for all utilities under the jurisdiction of the AEUB. Hearings were completed in January 2004. The decision from the AEUB is not expected until the third or fourth quarter of 2004.

In March 2004, ATCO Electric filed an application to settle several deferral account balances and to revise the 2004 interim distribution tariff to incorporate the AEUB decision regarding the revenue requirements for the 2003 and 2004 test years. In the application, ATCO Electric requested that an interim net refund rider be implemented for the period May 1, 2004, to December 31, 2004, to refund a total of approximately \$43 million to customers. On April 22, 2004, the AEUB approved this application as filed. This refund has no impact on earnings. ATCO Electric will be submitting a Phase II application in the second quarter of 2004 to finalize the interim distribution tariff.

In September 2003, ATCO Electric received approval from the AEUB to build a \$95.0 million, 350 kilometre 240 kilovolt transmission line between Fort McMurray and Whitefish Lake. The project includes three substations and the expansion of an existing substation, all of which are expected to be completed by August 31, 2004. As at March 31, 2004, ATCO Electric had completed approximately 75% of the project in record time, and on budget, and had expended \$74.4 million of the total project costs.

In August 2002, ATCO Gas filed a general rate application with the AEUB for the 2003 and 2004 test years. In December 2002, the AEUB issued a decision approving rates on an interim basis effective January 1, 2003. In a

decision dated October 1, 2003, the AEUB approved, among other things, a rate of return on common equity of 9.50% for 2003 and 2004 and a common equity ratio of 37%. Certain matters relating to transactions with affiliates will be addressed in separate proceedings during 2004. ATCO Gas, as directed by the AEUB, has refiled the 2003 and 2004 general rate application, incorporating the findings in the decision. In a decision dated April 28, 2004, the AEUB issued its final determination of the revenue requirements for the 2003 and 2004 test years, accepting the refiling with no material changes.

In October 2001, the AEUB approved the sale by ATCO Gas of certain properties located in the City of Calgary, known as the Calgary Stores Block, for \$6.6 million (excluding costs of disposition) and subsequently issued a decision allocating \$4.1 million of the proceeds to customers, and \$1.8 million to ATCO Gas. Leave to appeal this decision was granted on July 12, 2002. On January 27, 2004, the Alberta Court of Appeal issued a decision which overturned the AEUB decision and directed the AEUB to allocate \$5.4 million of the proceeds to ATCO Gas. Subsequent to the receipt of this decision, the AEUB and the City of Calgary filed for leave to appeal the Alberta Court of Appeal decision to the Supreme Court of Canada. Accordingly, ATCO Gas has not yet recorded the impact of the appeal decision.

In March 2004, the AEUB issued a decision respecting the operation of ATCO Gas' Carbon storage facility for the 2004/2005 storage year. The decision, among other things, directed ATCO Gas to reserve 16.7 petajoules of storage capacity for utility customers and allowed ATCO Midstream to continue to utilize the remaining uncontracted capacity at a rate of \$0.45 per gigajoule, up from \$0.41 per gigajoule. ATCO Gas has filed for leave to appeal this decision to the Alberta Court of Appeal.

In February 2003, ATCO Pipelines filed a general rate application for the 2003 and 2004 test years. In a decision dated December 2, 2003, the AEUB approved, among other things, a rate of return on common equity of 9.50% and a common equity ratio of 43.5% for 2003. The rate of return on common equity and the common equity ratio for 2004 will be determined as part of the generic cost of capital hearing. Certain matters relating to transactions with affiliates will be addressed in separate proceedings during 2004. ATCO Pipelines, as directed by the AEUB, has refiled the 2003 and 2004 general rate application, incorporating the findings in the decision. In a decision dated March 9, 2004, the AEUB approved interim rates to be effective from March 1, 2004, to October 31, 2004. In a decision dated April 30, 2004, the AEUB accepted the refiling of the revenue requirements for the 2003 and 2004 test years with no material changes.

In October 2003, ATCO Pipelines filed a 2004 Phase II general rate application for new rates. This application is part of a broader process through which the AEUB will address competitive issues between ATCO Pipelines and NOVA Gas Transmission Ltd. The hearing is expected to commence in May 2004.

LIQUIDITY AND CAPITAL RESOURCES

Cash flow from operations provides a substantial portion of the Corporation's cash requirements. Additional cash requirements are met externally through bank borrowings and the issuance of long term debt and preferred shares. Commercial paper borrowings and short term bank loans are used to provide flexibility in the timing and amounts of long term financing.

Cash flow from operations for the three months ended March 31, 2004, increased by \$11.4 million to \$134.4 million, primarily the result of:

- increased receipts of deferred availability incentives by Alberta Power (2000).

Investing for the three months ended March 31, 2004, increased by \$7.6 million to \$97.5 million, primarily due to:

- higher capital expenditures.

This increase was partially offset by:

- changes in non-cash working capital in respect of investing activities.

Capital expenditures for the three months ended March 31, 2004, increased by \$37.1 million to \$97.5 million, primarily due to:

- increased investment in regulated electric transmission and natural gas distribution projects.

During the three months ended March 31, 2004, the Corporation **issued** \$180.0 million of 5.432% Debentures due January 23, 2019.

At March 31, 2004, the Corporation had the following **credit lines** that enable it to obtain funding for general corporate purposes.

	Total	Used	Available
		(\$ Millions)	
Short term committed	300.0	40.0	260.0
Uncommitted	114.1	0.1	114.0
Total	414.1	40.1	374.0

The amount and timing of future financings will depend on market conditions and the specific needs of the Corporation.

Current and long term future income taxes of \$79.6 million at March 31, 2004, are attributable to differences between the financial statement carrying amounts of assets and liabilities and their tax bases. These differences result primarily from recognizing revenue and expenses in different years for financial and tax reporting purposes. Future income taxes will become payable when such differences are reversed through the settlement of liabilities and realization of assets.

BUSINESS RISKS

Transfer of Retail Energy Supply Functions

Although ATCO Gas and ATCO Electric have transferred to DEML certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions, ATCO Gas and ATCO Electric remain legally obligated to perform these functions if DEML fails to perform. If DEML fails to perform all or part of the transferred functions, ATCO Gas and ATCO Electric will be required under existing legislation to perform such functions in the interim until DEML is able to perform such functions. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the purchase to DEML by ATCO Gas and/or ATCO Electric. In certain circumstances, if DEML is restrained or prohibited from carrying out the transferred functions, all functions will revert to ATCO Gas and ATCO Electric and a portion of the purchase price will be refunded to DEML, depending upon the timing of any such reversion. In the event of a reversion of such functions, ATCO Gas and ATCO Electric could incur costs related to commodity procurement, transportation and delivery charges and various regulatory costs.

Centrica plc, DEML's parent, has provided a \$300 million guarantee, supported by a \$235 million letter of credit in respect of DEML's obligations to ATCO Gas, ATCO Electric and ATCO I-Tek Business Services Ltd. in respect of the ongoing relationships contemplated under the transaction agreements. However, there can be no assurance that the coverage under these agreements will be adequate to cover all of the costs that could arise in the event of a reversion of such functions.

Canadian Utilities has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek Business Services Ltd.'s payment and indemnity obligations in respect of the ongoing relationships contemplated under the transaction agreements.

As a result of the agreements with DEML, ATCO Gas and ATCO Electric are no longer involved in arranging for the supply and sale of natural gas and electricity to customers, but will continue to own the assets and provide transportation and distribution services under AEUB approved rates that provide for a recovery of costs of service and fair return.

In December 2003, the AEUB issued decisions approving the transfer of the retail operations of ATCO Gas and ATCO Electric to DEML. The City of Calgary has filed leave to appeal the AEUB decision, including the allocation of proceeds to ATCO Gas and ATCO Electric. The City of Calgary's application for leave to appeal is scheduled to be heard on June 8, 2004.

Alberta Power (2000)

As a result of unprecedented drought conditions, the water level in the cooling pond used by the Battle River plant in its production of electricity had fallen to an all-time low in early 2003, and the Corporation made a force majeure claim in respect of short term curtailed plant production which was experienced during the first quarter of 2003. Water levels continue to be below normal levels, however sufficient water is currently available to permit the plant to produce electricity according to its power purchase arrangement contractual requirements. Arbitration hearings commenced May 3, 2004, in respect of the force majeure claim.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2004, the Corporation retroactively adopted the Canadian Institute of Chartered Accountants ("CICA") recommendations on accounting for asset retirement obligations as described below. The prior year's financial statements have been restated for the change in the method of accounting for asset retirement obligations.

The CICA recommendations on accounting for asset retirement obligations require the Corporation to identify legal obligations associated with the retirement of tangible long lived assets. To the extent that they can be quantified, these obligations are measured and recognized at fair value, which is determined using present value techniques. An asset retirement obligation is recorded as a liability, with a corresponding increase to property, plant and equipment. The liability is accreted over the estimated time period until settlement of the obligation, with the accretion expense included in depreciation and amortization. The asset is depreciated over its estimated useful life. Prior to January 1, 2004, site restoration and removal costs that are now accounted for as asset retirement obligations were accrued over the estimated remaining useful lives of the assets.

Asset retirement obligations for regulated natural gas and electric transmission and distribution assets were not recognized as the date of final removal of the assets and the incurrence of the related retirement obligations was indeterminate. Asset retirement obligations have been recorded for the regulated generating plants of Alberta Power (2000).

The effect of adopting these recommendations is presented as increases (decreases) below:

	March 31	
	2004	2003
	(\$ Millions)	
<i>Statement of earnings</i>		
Depreciation and amortization	(0.3)	(0.6)
Accretion expense, included in depreciation and amortization	0.4	0.4
Earnings attributable to Class A and Class B shares	(0.1)	0.2
	January 1	
	2003	
	(\$ Millions)	
<i>Balance sheet</i>		
Retirement assets and site restoration and removal costs, included in property, plant and equipment		20.4
Asset retirement obligations, included in deferred credits		24.5
Retained earnings at beginning of period		(4.1)

Changes in asset retirement obligations are summarized below:

	March 31	
	2004	2003
	(\$ Millions)	
Obligations at beginning of period	25.9	24.5
Accretion expense	0.4	0.4
Obligations at end of period	26.3	24.9

The Corporation estimates the undiscounted amount of cash flow required to settle the asset retirement obligations is approximately \$63 million, which will be incurred between 2005 and 2026. A weighted average discount rate of 5.9% was used to calculate the fair value of the asset retirement obligations.

Effective January 1, 2004, the Corporation prospectively adopted the CICA recommendations on accounting for asset impairment. These recommendations require an impairment of property, plant and equipment, intangible assets with finite lives, deferred operating costs and long term prepaid expenses to be recognized in earnings when the asset's carrying value exceeds the total cash flows expected from its use and eventual disposition. The impairment loss is then calculated as the difference between the asset's carrying value and its fair value, which is determined using present value techniques. This change in accounting had no effect on earnings for the three months ended March 31, 2004.

Effective January 1, 2004, the Corporation prospectively adopted the CICA recommendations that define the primary sources of GAAP. While the recommendations encourage the application of the primary sources of GAAP to all operations, the recommendations do not require that assets and liabilities arising from rate regulation be recognized and measured in accordance with the primary sources of GAAP. The Corporation has chosen to retain its existing accounting policies for its regulated operations, which are permitted by GAAP.

May 4, 2004



CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE THREE MONTHS ENDED
MARCH 31, 2004**

CU INC.
CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS
(Millions of Canadian Dollars)

		Three Months Ended March 31	
	Note	2004	2003
			(Restated, Notes 1, 4) <i>(Unaudited)</i>
Revenues		\$ 960.0	\$1,099.2
Costs and expenses			
Natural gas supply		536.1	657.7
Purchased power		45.6	76.4
Operation and maintenance		74.8	75.5
Selling and administrative		52.1	45.0
Depreciation and amortization		59.4	55.7
Interest		36.9	36.1
Franchise fees		49.8	46.4
		854.7	992.8
		105.3	106.4
Interest and other income		1.6	1.3
Earnings before income taxes		106.9	107.7
Income taxes		39.6	41.5
		67.3	66.2
Dividends on equity preferred shares to parent corporation		3.5	3.5
Earnings attributable to Class A and Class B shares		63.8	62.7
Retained earnings at beginning of period as restated	3	1,003.4	925.2
		1,067.2	987.9
Dividends on Class A and Class B shares		20.2	18.8
Retained earnings at end of period		\$1,047.0	\$ 969.1

CU INC.
CONSOLIDATED BALANCE SHEET
(Millions of Canadian Dollars)

	March 31		December 31
	2004	2003	2003
		(Restated, Notes 1, 4)	(Restated, Notes 1, 4)
	<i>(Unaudited)</i>		<i>(Audited)</i>
ASSETS			
Current assets			
Cash and short term investments	\$ 122.4	\$ 27.6	\$ 42.8
Accounts receivable	414.8	520.1	429.3
Accounts receivable from parent and affiliate corporations	3.6	3.6	4.0
Inventories	41.3	42.8	155.9
Income taxes recoverable	-	7.1	21.4
Future income taxes	0.9	-	-
Deferred natural gas costs	-	36.1	27.2
Deferred electricity costs	-	9.5	-
Prepaid expenses	11.5	12.4	13.0
	594.5	659.2	693.6
Property, plant and equipment	3,462.6	3,294.3	3,438.5
Other assets	75.3	87.8	73.3
	\$4,132.4	\$4,041.3	\$4,205.4
LIABILITIES AND SHARE OWNER'S EQUITY			
Current liabilities			
Short term advances from parent and affiliate corporations	\$ 1.6	\$ 99.1	\$ 285.0
Accounts payable and accrued liabilities	262.4	228.4	284.1
Accounts payable to parent and affiliate corporations	47.5	86.6	80.7
Income taxes payable	13.7	-	-
Future income taxes	-	17.2	11.5
Deferred natural gas cost recoveries	10.1	-	-
Deferred electricity cost recoveries	28.5	-	1.0
Notes payable	-	36.0	-
Deferred electricity cost obligation	-	34.7	-
	363.8	502.0	662.3
Future income taxes	80.5	75.2	80.0
Deferred credits	114.5	87.4	113.1
Long term debt	1,862.5	1,743.5	1,682.5
Equity preferred shares to parent corporation	256.5	256.5	256.5
Class A and Class B share owner's equity			
Class A and Class B shares	407.6	407.6	407.6
Retained earnings	1,047.0	969.1	1,003.4
	1,454.6	1,376.7	1,411.0
	\$4,132.4	\$4,041.3	\$4,205.4

CU INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(Millions of Canadian Dollars)

	Three Months Ended March 31	
	2004	2003
		(Restated, Notes 1, 4) <i>(Unaudited)</i>
Operating activities		
Earnings attributable to Class A and Class B shares	\$ 63.8	\$ 62.7
Adjustments for:		
Depreciation and amortization	59.4	55.7
Future income taxes	0.7	0.3
Deferred availability incentives	8.1	4.1
Other	2.4	0.2
Cash flow from operations	134.4	123.0
Changes in non-cash working capital	167.3	(75.0)
	301.7	48.0
Investing activities		
Purchase of property, plant and equipment	(97.5)	(60.4)
Proceeds (costs) on disposal of property, plant and equipment	(0.6)	7.3
Contributions by utility customers for extensions to plant	16.8	14.1
Non-current deferred electricity costs	(9.7)	(14.1)
Changes in non-cash working capital	(3.9)	(38.8)
Other	(2.6)	2.0
	(97.5)	(89.9)
Financing activities		
Change in notes payable	-	36.0
Deferred electricity cost obligation	-	(16.3)
Issue of long term debt	180.0	-
Dividends paid to Class A and Class B share owner	(20.2)	(18.8)
Changes in non-cash working capital	-	1.0
Other	(1.0)	(0.6)
	158.8	1.3
Cash position ⁽¹⁾		
Increase (decrease)	363.0	(40.6)
Beginning of period	(242.2)	(30.9)
End of period	\$ 120.8	\$ (71.5)

⁽¹⁾ Cash position includes cash and short term investments less short term advances from parent and affiliate corporations.

CU INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2004
(Unaudited, Tabular Amounts in Millions of Canadian Dollars)

1. Financial statement presentation

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and should be read in conjunction with the Corporation’s December 31, 2003 consolidated financial statements and related notes. These interim financial statements have been prepared using the same accounting policies as used in the financial statements for the year ended December 31, 2003, except as described below.

Effective January 1, 2004, the Corporation retroactively adopted the Canadian Institute of Chartered Accountants (“CICA”) recommendations on accounting for asset retirement obligations as described in Note 4. The prior year’s financial statements have been restated for the change in the method of accounting for asset retirement obligations.

Effective January 1, 2004, the Corporation prospectively adopted the CICA recommendations on accounting for asset impairment. These recommendations require an impairment of property, plant and equipment, intangible assets with finite lives, deferred operating costs and long term prepaid expenses to be recognized in earnings when the asset’s carrying value exceeds the total cash flows expected from its use and eventual disposition. The impairment loss is then calculated as the difference between the asset’s carrying value and its fair value, which is determined using present value techniques. This change in accounting had no effect on earnings for the three months ended March 31, 2004.

Effective January 1, 2004, the Corporation prospectively adopted the CICA recommendations that define the primary sources of GAAP. While the recommendations encourage the application of the primary sources of GAAP to all operations, the recommendations do not require that assets and liabilities arising from rate regulation be recognized and measured in accordance with the primary sources of GAAP. The Corporation has chosen to retain its existing accounting policies for its regulated operations, which are permitted by GAAP, as described in Note 2.

Due to the seasonal nature of the Corporation’s operations and the timing of rate decisions, the consolidated statements of earnings and retained earnings for the three months ended March 31, 2004 and March 31, 2003 are not necessarily indicative of operations on an annual basis.

Certain 2003 figures have been reclassified to conform to the current presentation.

2. Regulation

ATCO Electric, the ATCO Gas and ATCO Pipelines divisions of ATCO Gas and Pipelines Ltd. and the generating plants of Alberta Power (2000) are collectively referred to in these consolidated financial statements as the “regulated operations”.

ATCO Electric, ATCO Gas and ATCO Pipelines are regulated primarily by the Alberta Energy and Utilities Board (“AEUB”), which administers acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. The AEUB may approve interim rates, subject to final determination.

The generating plants of Alberta Power (2000) were regulated by the AEUB until December 31, 2000 but are now governed by legislatively mandated Power Purchase Arrangements (“PPA”) that were approved by the AEUB. These plants are included in regulated operations primarily because the PPA’s are designed to allow the owners of generating plants constructed before January 1, 1996 to recover their forecast fixed and variable costs and to earn a return at the rate specified in the PPA’s. The plants will become deregulated upon the expiry of the PPA’s. Each PPA is to remain in effect until the earlier of the last day of the life of the related generating plant and December 31, 2020.

2. Regulation (continued)

Differences between the Corporation's accounting policies for its regulated operations and the primary sources of GAAP occur when the AEUB renders its decisions on the Corporation's rate applications and generally involve the timing of revenue and expense recognition to ensure that the Corporation has achieved proper matching of revenues and expenses. Where regulatory practice dictates, the Corporation defers certain costs or revenues as assets or liabilities in the balance sheet and records them as expenses or revenues in the earnings statement as it collects or refunds amounts through future customer rates. Any differences between the amounts deferred and amounts approved by the AEUB for collection or refund in future customer rates are recognized in earnings in the period that the AEUB renders a decision. The Corporation anticipates that there would be no material differences between the amounts approved by the AEUB for collection or refund and the amounts included in assets or liabilities on the balance sheet.

The significant accounting policies that differ from those required by the primary sources of GAAP are described as follows:

- a) *Depreciation* – Depreciation rates for regulated assets are approved by the AEUB or, in the case of Alberta Power (2000)'s generating plants, are determined by the PPA's.
- b) *Future removal and site restoration costs* – Depreciation rates for regulated assets, excluding Alberta Power (2000)'s generating plants, include a provision for future removal costs and site restoration costs. On retirement of these depreciable regulated assets, the accumulated depreciation is charged with the cost of the retired unit, net disposal costs and site restoration costs.
- c) *Allowance for funds used during construction* – Certain regulated operations include in property, plant and equipment an allowance for funds used during construction at rates approved by the AEUB for debt and equity capital.
- d) *Employee future benefits* – Costs of employee future benefits in the regulated operations, excluding Alberta Power (2000), are recognized in earnings when paid rather than accrued. The differences between the amounts accrued and paid are deferred.

Significant accounting policies that are consistent with those required by the primary sources of GAAP for items that are subject to regulatory approval include:

- a) *Natural gas supply* – Natural gas supply expense is based on the forecast cost of natural gas included in customer rates. Variances from forecast costs are deferred until such time as approval from the AEUB is obtained for refund to or collection from customers and revenues and natural gas supply expense are adjusted accordingly.
- b) *Purchased power* – Purchased power expense is based on the actual cost of electricity purchased, whereas the amount included in customer rates is based on forecast cost. Revenues are adjusted for variances from forecast cost, and the variances are deferred until such time as approval from the AEUB is obtained for refund to or collection from customers.
- c) *Income taxes* – The regulated operations follow the method of accounting for income taxes that is consistent with the method of determining the income tax component of their rates. When future income taxes are not provided in the income tax component of current rates, such future income taxes are not recognized to the extent that it is expected that they will be recovered from customers through inclusion in future rates.
- d) Certain costs as required or permitted by the AEUB are deferred for recovery through future rates.

3. Retained earnings at beginning of period as restated

	March 31	
	2004	2003
Retained earnings at beginning of period as previously reported	\$1,007.1	\$929.3
Adjustment to retained earnings for prior years' effect of change in method of accounting for asset retirement obligations (after income taxes)	(3.7)	(4.1)
Retained earnings at beginning of period as restated	\$1,003.4	\$925.2

4. Asset retirement obligations

The CICA recommendations on accounting for asset retirement obligations require the Corporation to identify legal obligations associated with the retirement of tangible long lived assets. To the extent that they can be quantified, these obligations are measured and recognized at fair value, which is determined using present value techniques. An asset retirement obligation is recorded as a liability, with a corresponding increase to property, plant and equipment. The liability is accreted over the estimated time period until settlement of the obligation, with the accretion expense included in depreciation and amortization. The asset is depreciated over its estimated useful life. Prior to January 1, 2004, site restoration and removal costs that are now accounted for as asset retirement obligations were accrued over the estimated remaining useful lives of the assets.

Asset retirement obligations for regulated natural gas and electric transmission and distribution assets were not recognized as the date of final removal of the assets and the incurrence of the related retirement obligations was indeterminate. Asset retirement obligations have been recorded for the regulated generating plants of Alberta Power (2000).

The effect of adopting these recommendations is presented as increases (decreases) below:

	March 31	
	2004	2003
<i>Statement of earnings</i>		
Depreciation and amortization	\$(0.3)	\$(0.6)
Accretion expense, included in depreciation and amortization	0.4	0.4
Earnings attributable to Class A and Class B shares	\$(0.1)	\$ 0.2
		January 1
		2003
<i>Balance sheet</i>		
Retirement assets and site restoration and removal costs, included in property, plant and equipment		\$20.4
Asset retirement obligations, included in deferred credits		24.5
Retained earnings at beginning of period		(4.1)

Changes in asset retirement obligations are summarized below:

	March 31	
	2004	2003
Obligations at beginning of period	\$25.9	\$24.5
Accretion expense	0.4	0.4
Obligations at end of period	\$26.3	\$24.9

The Corporation estimates the undiscounted amount of cash flow required to settle the asset retirement obligations is approximately \$63 million, which will be incurred between 2005 and 2026. A weighted average discount rate of 5.9% was used to calculate the fair value of the asset retirement obligations.

5. Employee future benefits

In the three months ended March 31, 2004, net expense of \$0.5 million (2003 – \$0.4 million) was recognized for pension benefit plans and net expense of \$0.3 million (2003 – \$0.2 million) was recognized for other post employment benefit plans.

6. Segmented information

Three months ended March 31

	Natural Gas and Electric	Power Generation	Corporate and Other	Intersegment Eliminations	Consolidated
2004					
2003					
Revenues – external	\$ 883.1 \$1,021.3	\$ 76.9 \$ 77.9	\$ - \$ -	\$ - \$ -	\$ 960.0 \$1,099.2
Revenues – intersegment	1.0 1.4	- -	- -	(1.0) (1.4)	- -
Revenues	\$ 884.1 \$1,022.7	\$ 76.9 \$ 77.9	\$ - \$ -	\$(1.0) \$(1.4)	\$ 960.0 \$1,099.2
Earnings attributable to Class A and Class B shares	\$ 49.9 \$ 49.5	\$ 13.6 \$ 13.2	\$0.3 \$ -	\$ - \$ -	\$ 63.8 \$ 62.7
Total assets	\$3,324.1 \$3,246.9	\$809.3 \$794.5	\$0.9 \$0.4	\$(1.9) \$(0.5)	\$4,132.4 \$4,041.3

7. Subsequent events

Transfer of retail energy supply functions

On May 4, 2004, ATCO Gas, ATCO Electric and Direct Energy Marketing Limited, a subsidiary of Centrica plc, closed the transfer of the retail energy supply businesses of ATCO Gas and ATCO Electric to Direct Energy Marketing Limited and one of its affiliates (collectively “DEML”). The transaction was previously announced in December 2002. Amendments to the previously announced transaction, which occurred primarily as a result of legislative amendments and regulatory changes in 2003, include proceeds of \$90 million (reduced from the originally announced \$128 million), of which \$45 million was paid at closing, with the remainder to be paid 12 months following closing.

Under the various transaction agreements, ATCO Gas and ATCO Electric have transferred to DEML certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions.

If DEML fails to perform all or part of the transferred functions, ATCO Gas and ATCO Electric will be required under existing legislation to perform such functions in the interim until DEML is able to perform such functions. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the agreements will terminate and the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and/or ATCO Electric. In certain circumstances, if DEML is restrained or prohibited from carrying out the transferred functions, all functions will revert to ATCO Gas and ATCO Electric and a portion of the purchase price will be refunded to DEML, depending upon the timing of any such reversion.

Centrica plc, DEML’s parent, has provided a \$300 million guarantee supported by a \$235 million letter of credit in respect of DEML’s obligations to ATCO Gas, ATCO Electric and ATCO I-Tek Business Services Ltd. in respect of the ongoing relationships contemplated under the transaction agreements. The Centrica guarantee and letter of credit include limits for certain categories of claims, which limits cease to apply if the agreements are terminated. If the amount available to be drawn under the letter of credit at any time falls below \$200 million, the agreements with DEML will terminate and the functions will revert to ATCO Gas and ATCO Electric with no refund of the purchase price to DEML by ATCO Gas and ATCO Electric.

7. Subsequent events (continued)

Canadian Utilities has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek Business Services Ltd.'s payment and indemnity obligations in respect of the ongoing relationships contemplated under the transaction agreements.

On May 4, 2004, DEML commenced supplying natural gas and electricity at regulated rates to residential, farm and small business customers in the ATCO Gas and ATCO Electric service areas and billing customers for their natural gas and electricity service. Consequently, the Corporation's revenues and natural gas supply and purchased power costs in subsequent periods will be reduced accordingly. There will be no impact on earnings resulting from the discontinuance of these functions as natural gas and electricity have historically been sold to customers on a "no-margin" basis. Current employee levels of ATCO Gas and ATCO Electric are not expected to materially change as a result of this transaction. ATCO Gas and ATCO Electric continue to own and operate the natural gas and electricity distribution systems used to deliver energy.

ATCO Gas and ATCO Electric have also agreed not to compete in the regulated and unregulated retail energy business in Alberta for a period of ten years.

In December 2003, the AEUB issued decisions approving the transfer of the retail operations of ATCO Gas and ATCO Electric to DEML. The City of Calgary has filed leave to appeal the AEUB decision, including the allocation of proceeds to ATCO Gas and ATCO Electric. The City of Calgary's application for leave to appeal is scheduled to be heard on June 8, 2004.

Regulatory matters

In August 2002, ATCO Gas filed a general rate application with the AEUB for the 2003 and 2004 test years. In December 2002, the AEUB issued a decision approving rates on an interim basis effective January 1, 2003. In a decision dated October 1, 2003, the AEUB approved, among other things, a rate of return on common equity of 9.50% for 2003 and 2004 and a common equity ratio of 37%. Certain matters relating to transactions with affiliates will be addressed in separate proceedings during 2004. ATCO Gas, as directed by the AEUB, has refiled the 2003 and 2004 general rate application, incorporating the findings in the decision. In a decision dated April 28, 2004, the AEUB issued its final determination of the revenue requirements for the 2003 and 2004 test years, accepting the refiling with no material changes.

In February 2003, ATCO Pipelines filed a general rate application for the 2003 and 2004 test years. In a decision dated December 2, 2003, the AEUB approved, among other things, a rate of return on common equity of 9.50% and a common equity ratio of 43.5% for 2003. The rate of return on common equity and the common equity ratio for 2004 will be determined as part of the generic cost of capital hearing. Certain matters relating to transactions with affiliates will be addressed in separate proceedings during 2004. ATCO Pipelines, as directed by the AEUB, has refilled the 2003 and 2004 general rate application, incorporating the findings in the decision. In a decision dated March 9, 2004, the AEUB approved interim rates to be effective from March 1, 2004 to October 31, 2004. In a decision dated April 30, 2004, the AEUB accepted the refiling of the revenue requirements for the 2003 and 2004 test years with no material changes.