

TORONTO HYDRO CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE INTERIM PERIOD ENDED
MARCH 31, 2006

The following discussion and analysis should be read in conjunction with:

- the unaudited interim consolidated financial statements and accompanying notes of Toronto Hydro Corporation (the "Corporation") as at and for the three-month period ended March 31, 2006 (the "Interim Consolidated Financial Statements");
- the audited consolidated financial statements and accompanying notes of the Corporation as at and for the year ended December 31, 2005 (the "Annual Consolidated Financial Statements"); and
- management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2005 (including the sections entitled "Electricity Industry", "Quarterly Results of Operations", "Liquidity and Capital Resources", "Corporate Developments", "Consumers' Gas Decision", "Share Capital", "Services Provided to the City of Toronto", "Risks and Uncertainties", "Risk Management" and "Significant Accounting Policies" which remain substantially unchanged as at the date hereof except as noted below or as updated by the Interim Consolidated Financial Statements).

Copies of these documents are available on the Canadian Securities Administrators' web site at www.sedar.com.

The Interim Consolidated Financial Statements are prepared in accordance with Canadian generally accepted accounting principles, including accounting principles prescribed by the Ontario Energy Board (the "OEB"), and are presented in Canadian dollars. In preparing the Interim Consolidated Financial Statements, management makes estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the Interim Consolidated Financial Statements and the reported amounts of revenues and expenses for the periods covered thereby. Actual results could differ from those estimates, including changes as a result of future decisions made by the OEB, the Minister of Energy or the Minister of Finance. The significant accounting policies of the Corporation are summarized in note 3 to the Annual Consolidated Financial Statements and in note 2 to the Interim Consolidated Financial Statements.

Business of Toronto Hydro

The Corporation is a holding company, which wholly-owns the following subsidiaries:

- *Toronto Hydro-Electric System Limited* ("LDC") - which distributes electricity;
- *Toronto Hydro Energy Services Inc.* ("TH Energy") - which manages an existing portfolio of electricity contracts and provides energy efficiency products and services;
- *Toronto Hydro Telecom Inc.* ("Telecom") - which provides fibre optic cable capacity and manages data communications services; and
- *Toronto Hydro Street Lighting Inc.* ("Street Lighting") - which provides street lighting and expressway lighting services.

The principal business of the Corporation and its subsidiaries is the distribution of electricity by LDC. LDC owns and operates an electricity distribution system, which delivers electricity to approximately 677,000 customers located in the City of Toronto (the "City"). LDC is the largest municipal electricity distribution company in Canada and distributes approximately 19% of the electricity consumed in Ontario. The business of LDC is regulated by the OEB which has broad powers relating to licensing, standards of conduct and service and the regulation of rates charged by LDC and other electricity distributors in Ontario. See note 2 to the Consolidated Financial Statements.

Selected Interim Consolidated Financial Data

The selected interim consolidated financial data presented below should be read in conjunction with the Interim Consolidated Financial Statements.

Interim Consolidated Statement of Income Data Three months ended March 31 (in thousands of dollars, except for per share amounts, unaudited)				
	2006	2005	Change	Change
	\$	\$	\$	%
Revenues	565,660	612,826	(47,166)	(7.7%)
Costs				
Purchased power and other	432,106	478,171	(46,065)	(9.6%)
Operating expenses	43,336	45,919	(2,583)	(5.6%)
Depreciation and amortization	34,679	34,510	169	0.5%
	<u>510,121</u>	<u>558,600</u>	<u>(48,479)</u>	<u>(8.7%)</u>
Income before interest and provision for payments in lieu of corporate taxes ("PILs")	55,539	54,226	1,313	2.4%
Interest income	4,412	3,404	1,008	29.6%
Interest expense				
Long-term debt	(20,101)	(20,101)	-	-
Other interest	(945)	(636)	(309)	(48.6%)
	<u>38,905</u>	<u>36,893</u>	<u>2,012</u>	<u>5.5%</u>
Income before provision for PILs	38,905	36,893	2,012	5.5%
Provision for PILs	16,346	16,057	289	1.8%
	<u>22,559</u>	<u>20,836</u>	<u>1,723</u>	<u>8.3%</u>
Net income for the period	22,559	20,836	1,723	8.3%
Basic and diluted net income per share	22,559	20,836	1,723	8.3%

Interim Consolidated Balance Sheet Data (in thousands of dollars, unaudited)		
	As at March 31, 2006	As at December 31, 2005
	\$	\$
Total assets	2,665,899	2,819,258
Current liabilities	449,028	941,211
Long-term liabilities	1,375,645	1,032,180
Total liabilities	<u>1,824,673</u>	<u>1,973,391</u>
Shareholder's equity	841,226	845,867
Total liabilities and shareholder's equity	<u>2,665,899</u>	<u>2,819,258</u>

Results of Operations

Net Income

Net income for the three months ended March 31, 2006 was \$22.6 million compared to \$20.8 million for the comparable period in 2005. The increase was primarily due to decreased operating expenses (\$2.6 million) partially offset by decreased net revenues (\$1.1 million).

Net Revenues

Net revenues (revenues minus the cost of purchased power and other) for the three months ended March 31, 2006 were \$133.6 million compared to \$134.7 million for the comparable period in 2005. The decrease was primarily due to decreased net revenues at TH Energy (\$6.4 million) partially offset by increased net revenues at Street Lighting (\$2.7 million), at Telecom (\$1.6 million) and at LDC (\$0.7 million).

At TH Energy, the decrease in net revenues was primarily due to decreased future unrealized gain in the mark-to-market valuation of the electricity portfolio (\$4.4 million), decreased contribution from business protection plan rebates (\$3.7 million) and lower consumption due to expired retail contracts (\$2.7 million). This was partially offset by an increase in the realized gain of the electricity portfolio (\$4.2 million).

At Street Lighting, the increase in net revenues was primarily due to additional revenue resulting from street and expressway lighting services provided by Street Lighting to the City (effective January 1, 2006) under the terms of a service agreement entered into as part of the purchase by the Corporation of the street and expressway lighting assets of the City on December 31, 2005.

At Telecom, the increase in net revenues was primarily due to increased sales of data services.

At LDC, the increase in net revenues was primarily due to the net effect of the third adjustment to achieve a market-based rate of return after deferral for conservation and demand management programs (\$4.1 million) partially offset by lower distribution revenue from decreased consumption attributable to weather (\$2.3 million) and decreased other revenues from customer demand work (\$1.0 million).

Expenses

Operating expenses for the three months ended March 31, 2006 were \$43.3 million compared to \$45.9 million for the comparable period in 2005. The decrease was primarily due to decreased property tax accrual at LDC (\$3.3 million).

Depreciation and amortization expense for the three months ended March 31, 2006 was \$34.7 million compared to \$34.5 million for the comparable period in 2005.

Net interest expense for the three months ended March 31, 2006 was \$16.6 million compared to \$17.3 million for the comparable period in 2005.

Provision for PILs

Provision for PILs for the three months ended March 31, 2006 was \$16.3 million compared to \$16.1 million for the comparable period in 2005.

Liquidity and Capital Resources

The Corporation's primary sources of liquidity and capital resources are cash provided by operating activities, short-term bank financing, interest income and debt capital market borrowings. The Corporation's primary liquidity and capital resource requirements are for capital expenditures to maintain and improve the electricity distribution system of LDC, interest expense and prudential requirements and third party credit support.

Capital Resources and Liquidity
Three months ended March 31
(in thousands of dollars, unaudited)

	2006	2005
	\$	\$
Cash and cash equivalents, beginning of period	448.4	386.6
Net cash provided by (used in) operating activities	(29.3)	47.0
Net cash used in investing activities	(51.6)	(21.7)
Net cash used in financing activities	(32.4)	(75.2)
Cash and cash equivalents, end of period	335.1	336.7

Cash Used in Operating Activities

Cash used in operating activities for the three months ended March 31, 2006 was \$29.3 million compared to cash provided by operating activities of \$47.0 million for the comparable period in 2005. The decrease was primarily due to unfavourable variances in accounts payable and accrued liabilities (\$99.5 million) resulting from decreased electricity payables at LDC and TH Energy and an unfavourable variance in accounts receivables (\$21.3 million) due to increased receivables at LDC, partially offset by a variance in unbilled revenues (\$31.4 million) at LDC.

Cash Used in Investing Activities

Cash used in investing activities for the three months ended March 31, 2006 was \$51.6 million compared to \$21.7 million for the comparable period in 2005. The increase was primarily due to increased capital expenditures (\$23.4 million) and increased regulatory assets and liabilities variance (\$6.8 million) due to the new Global Adjustment rebate at LDC.

Cash Used in Financing Activities

Cash used in financing activities for the three months ended March 31, 2006 was \$32.4 million compared to \$75.2 million for the comparable period in 2005. The decrease was primarily due to a decrease in customer deposits due to a new OEB direction (\$20.9 million) and lower dividends paid in 2006 (\$21.8 million).

Capital Expenditures
Three months ended March 31
(in thousands of dollars, unaudited)

	2006	2005
	\$	\$
LDC		
Distribution System	33,909	18,867
Technology assets	5,635	732
Other ⁽¹⁾	3,203	110
	42,747	19,709
Other ⁽²⁾	2,283	1,941
Total Capital Expenditures	45,030	21,650

Notes:

- (1) Consists of vehicles, other work-related equipment, furniture and office equipment.
- (2) Includes capital expenditures relating to TH Energy, Street Lighting and Telecom.

Revolving Credit Facility

The Corporation is a party to a credit agreement with respect to a revolving credit facility dated May 5, 2005 pursuant to which the Corporation may borrow up to \$500.0 million, of which up to \$175.0 million is available in the form of letters of credit. As at March 31, 2006, no borrowings for working capital were outstanding and letters of credit in the amount of \$85.6 million had been issued. See note 4 to the Interim Consolidated Financial Statements.

Prudential Requirements and Third Party Credit Support

As at March 31, 2006, the Corporation had issued \$56.5 million of parental guarantees on behalf of TH Energy in support of prudential requirements to third parties for the purchase and sale of electricity and had issued \$18.4 million of parental guarantees to the City as part of an agreement by the City to purchase electricity at a fixed price from TH Energy. See note 9 to the Interim Consolidated Financial Statements.

Dividends

On March 2, 2006, the board of directors of the Corporation declared dividends in the amount of \$27.2 million. The dividends are comprised of a \$21.2 million payment for 2005 net income, which was paid on March 10, 2006 and a \$6.0 million payment in connection with the first quarter of 2006, which was paid on March 31, 2006.

On May 29, 2006, the board of directors of the Corporation declared a dividend in the amount of \$6.0 million in respect of the second quarter of 2006, payable on June 30, 2006.

Corporate Developments

2006 Rate Application

On April 12, 2006, the OEB approved a decrease in LDC's distribution rates for the period May 1, 2006 to April 30, 2007 representing a revenue reduction of approximately \$53.5 million. The methodology used by the OEB to establish the distribution rates was based on, among other things, a rate base of \$1.861 billion, a deemed debt equity structure of 65:35 and an allowed return on equity of 9%. The OEB also allowed for the recovery of regulatory assets related to prior years' pension costs and OEB fees and reduced the allowable interest rate on the existing related party debt instrument from 6.8% to 5% per annum. LDC currently has a promissory note in the principal amount of \$980.2 million payable to the Corporation.

City Promissory Note

The Corporation currently has a promissory note in the principal amount of \$980.2 million payable to the City ("City Note"). See note 5b) to the Interim Consolidated Financial Statements. A copy of the City Note is available at www.sedar.com. The Corporation is currently evaluating the impact on the City Note of the decrease in the allowable affiliate debt rate included in the 2006 distribution rate decision received from the OEB for LDC as discussed above in "2006 Rate Application". The Corporation is currently in discussions with the City with respect to possible amendments to the City Note.

Ministry of Finance Tax Audit

Certain filing positions for PILs were taken by the Corporation and its subsidiaries that may be challenged on audit. This may result in a material increase in the Corporation's reported tax obligations upon reassessment. As the current PILs audit has not yet been completed, management is not able to determine the impact of this uncertainty on the Interim Consolidated Financial Statements or the Corporation's tax reserves. The range and level of the Corporation's tax reserves are adjusted when there is sufficient information available, or when an event occurs requiring a change to the reserves.

Consumers' Gas Decision

On April 22, 2004, in a decision in a class action commenced against The Consumers' Gas Company Limited (now Enbridge Gas Distribution Inc.), the Supreme Court of Canada ruled that The Consumers' Gas Company ("Consumers' Gas") was required to repay that portion of certain late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. Although the claim related to charges collected by Consumers' Gas after the enactment of section 347 of the Criminal Code in 1981, the Supreme Court limited recovery to charges collected after the action was initiated in 1994. The Supreme Court remitted the matter back to the Ontario Superior Court of Justice for a determination of the plaintiffs' damages.

The Corporation is not a party to the Consumers' Gas class action. It is, however, subject to the two class actions described below in which the issues are analogous.

The first is an action commenced against a predecessor of LDC and other Ontario municipal electric utilities under the Class Proceedings Act, 1992 seeking \$500 million in restitution for late payment charges collected by them from their customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. This action is at a preliminary stage. Pleadings have closed but examinations for discovery have not been conducted and the classes have not been certified as the parties were awaiting the outcome of the Consumers' Gas class action.

The second is an action commenced against a predecessor of LDC under the *Class Proceedings Act, 1992* seeking \$64 million in restitution for late payment charges collected by it from its customers that were in excess of the interest limit stipulated in section 347 of the Criminal Code. This action is also at a preliminary stage. Pleadings have closed and examinations for discovery have been conducted but, as in the first action, the classes have not been certified as the parties were awaiting the outcome of the Consumers' Gas class action.

The claims made against LDC and the definitions of the plaintiff classes are identical in both actions. As a result, any damages payable by LDC in the first action would reduce the damages payable by LDC in the second action, and vice versa.

It is anticipated that the first action will now proceed for determination in light of the reasons of the Supreme Court in the Consumers' Gas class action.

LDC may have defences available to it in these actions that were not disposed of by the Supreme Court in the Consumers' Gas class action.

Also, the determination of whether the late payment charges collected by LDC from its customers were in excess of the interest limit stipulated in section 347 of the Criminal Code is fact specific in each circumstance. Accordingly, given the preliminary status of these actions, it is not possible at this time to reasonably quantify the effect, if any, of the Consumers' Gas decision on these actions or of these actions on the financial performance of the Corporation.

Forward-Looking Information

Certain information included herein constitutes "forward-looking information". Forward-looking information means disclosure regarding possible events, conditions or results that is based on assumptions about future economic conditions and courses of action. In some cases, forward looking information can be identified by terminology such as "may", "will", "should", "expect", "anticipate", "believe", "estimate", "predict", "potential", "budget", "continue" or the negative of these terms or other comparable terminology. In addition, certain information included herein may contain forward-looking information attributable to third parties. Although the Corporation believes that it has a reasonable basis for the forward-looking information included herein, such information is subject to a number of risks and uncertainties that may cause actual events, conditions or results to differ materially from those contemplated by the forward-looking information. Some of the factors that could cause such differences include legislative or regulatory developments, financial market conditions, the ratings assigned to the Corporation and its debt securities by rating agencies, general economic conditions and weather. The Corporation does not undertake any obligation to update publicly or to revise any of the forward-looking information included herein after the date hereof, whether as a result of new information, future events or otherwise.

Additional Information

Additional information with respect to the Corporation (including its annual information form) is available on the Canadian Securities Administrators' web site at www.sedar.com.

Toronto, Canada

May 31, 2006