**EnerCare Solutions Inc.**

**Consolidated Financial Statements**

**Year Ended December 31, 2012**

**Dated February 27, 2013**

February 27, 2013

## Independent Auditor's Report

**To the Shareholders of**

**EnerCare Solutions Inc.**

We have audited the accompanying consolidated financial statements of EnerCare Solutions Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

**Management's responsibility for the consolidated financial statements**
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of EnerCare Solutions Inc. and its subsidiaries as at December 31, 2012 and December 31, 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Accountants, Licensed Public Accountants**

*PricewaterhouseCoopers LLP*
*PwC Tower, 18 York Street, Suite 2600, Toronto, Ontario, Canada M5J 0B2*
*T: +1 416 863 1133, F: +1 416 365 8215, www.pwc.com/ca*

# EnerCare Solutions Inc.
## Consolidated Statements of Financial Position

| As at December 31, (in thousands of Cdn $) | | 2012 | | 2011 |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents (note 4) | $ | 3,617 | $ | 50,403 |
| Accounts receivable (note 5) | | 16,384 | | 19,638 |
| Prepaid and other assets | | 857 | | 750 |
| Dividends receivable | | - | | 8,460 |
| Investment in EnerCare Connections Inc. preferred shares (note 11) | | 50,000 | | 250,000 |
| | | 70,858 | | 329,251 |
| **Capital assets (note 7)** | | 411,022 | | 422,596 |
| **Intangible assets (note 8)** | | 283,232 | | 329,625 |
| **Deferred tax asset (note 12)** | | 348 | | 485 |
| | $ | 765,460 | $ | 1,081,957 |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Current portion of long-term debt (note 9) | $ | - | $ | 60,000 |
| Accounts payable and accrued liabilities (note 6) | | 19,134 | | 22,819 |
| Related party payable (note 20) | | 1,936 | | 459 |
| Provisions (note 18) | | 726 | | 1,592 |
| Interest payable | | 4,228 | | 7,333 |
| Interest payable on subordinated debt | | - | | 8,582 |
| Dividends payable | | 3,249 | | 3,091 |
| Subordinated debt (note 11) | | 50,000 | | 250,000 |
| | | 79,273 | | 353,876 |
| **Long-term debt (note 9)** | | 517,508 | | 508,054 |
| **Long-term subordinated promissory notes (note 10)** | | 250,000 | | 100,000 |
| **Deferred tax liability (note 12)** | | 133,690 | | 143,523 |
| | | 980,471 | | 1,105,453 |
| **Shareholders' equity (note 13)** | | (215,011) | | (23,496) |
| | $ | 765,460 | $ | 1,081,957 |

The accompanying notes are an integral part of these consolidated financial statements.

# EnerCare Solutions Inc.

## Consolidated Statements of Income

| For the years ended December 31, (in thousands of Cdn $, except per share amounts) | | 2012 | | 2011 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Rentals and services | **$** | **186,288** | $ | 186,524 |
| Dividend income | | **10,342** | | 8,460 |
| Investment income | | **402** | | 368 |
| Total revenues | | **197,032** | | 195,352 |
| **Expenses** | | | | |
| Selling, general & administrative (note 17) | | **27,579** | | 26,457 |
| Amortization | | | | |
| Capital assets | | **50,868** | | 55,308 |
| Intangibles | | **46,393** | | 46,395 |
| Loss on disposal of equipment | | **15,148** | | 19,099 |
| Interest | | | | |
| Short-term | | **141** | | 215 |
| Make-whole charge on early redemption of debt | | **1,920** | | - |
| Long-term | | **37,427** | | 39,398 |
| Subordinated debt | | **10,490** | | 8,582 |
| Promissory notes | | **10,174** | | 4,500 |
| Total operating expenses | | **200,140** | | 199,954 |
| **Other income (note 22)** | | **1,138** | | **-** |
| **Loss for the period before income taxes** | | **(1,970)** | | (4,602) |
| **Tax expense** | | | | |
| Current tax expense (note 12) | | **13,896** | | 5,380 |
| Deferred income tax (recovery) (note 12) | | **(9,696)** | | (9,705) |
| Total tax expense/(recovery) | | **4,200** | | (4,325) |
| **Net loss for the period** | **$** | **(6,170)** | $ | (277) |

# EnerCare Solutions Inc.

## Condensed Interim Consolidated Statements of Comprehensive Income

| For the years ended December 31, (in thousands of Cdn $) | | 2012 | | 2011 |
|---|---|---|---|---|
| **Net loss for the period** | **$** | **(6,170)** | $ | (277) |
| Amortization of accumulated other comprehensive loss to net (loss)/earnings | | **3,258** | | 3,694 |
| **Comprehensive (loss)/income for the period** | **$** | **(2,912)** | $ | 3,417 |

The accompanying notes are an integral part of these consolidated financial statements.

# EnerCare Solutions Inc.

## Consolidated Statements of Changes in Equity

| For the years ended December 31, (in thousands of Cdn $) | | 2012 | | 2011 |
|---|---|---|---|---|
| **Share Capital** | | | | |
| Balance - beginning of period | **$** | **79,614** | $ | 79,614 |
| Shares issued | | **-** | | - |
| **Share Capital - end of period (note 13)** | | **79,614** | | 79,614 |
| **Accumulated Other Comprehensive Loss** | | | | |
| Balance - beginning of period | | **(7,281)** | | (10,975) |
| Amortization | | **3,258** | | 3,694 |
| **Accumulated Other Comprehensive Loss - end of period** | | **(4,023)** | | (7,281) |
| **Retained Deficit** | | | | |
| Balance - beginning of period | | **(95,829)** | | (341,068) |
| Net loss for the period | | **(6,170)** | | (277) |
| (Decrease)/increase in equity on reduction to and issuance of additional promissory notes (note 10) | | **(150,000)** | | 281,582 |
| Dividends | | **(38,603)** | | (36,066) |
| **Retained Deficit - end of period** | | **(290,602)** | | (95,829) |
| **Shareholders' equity - end of period** | **$** | **(215,011)** | $ | (23,496) |

The accompanying notes are an integral part of these consolidated financial statements.

# EnerCare Solutions Inc.

## Consolidated Statements of Cash Flows

| For the years ended December 31, (in thousands of Cdn $) | 2012 | 2011 |
|---|---|---|
| **Cash provided by/(used in):** | | |
| **Operating activities** | | |
| Net loss for the period | $ (6,170) | $ (277) |
| Items not affecting cash | | |
| Amortization | | |
| Capital assets | 50,868 | 55,308 |
| Intangibles | 46,393 | 46,395 |
| Loss on disposal of equipment (note 7) | 15,148 | 19,099 |
| Non-cash interest expense | 4,498 | 4,895 |
| Deferred income tax (recovery) (note 12) | (9,696) | (9,705) |
| **Operating cash flow** | 101,041 | 115,715 |
| Net change in non-cash working capital (note 19) | (3,154) | 6,265 |
| **Cash provided by operating activities** | 97,887 | 121,980 |
| **Investing activities** | | |
| Purchase of equipment (note 7) | (57,877) | (60,679) |
| Acquisitions (note 21) | (1,944) | - |
| Proceeds from disposal of equipment (note 7) | 5,379 | 3,932 |
| **Cash used in investing activities** | (54,442) | (56,747) |
| **Financing activities** | | |
| Dividends to shareholders | (38,445) | (32,975) |
| Purchase of preferred shares | - | (250,000) |
| Sale of preferred shares | 200,000 | - |
| Issuance of subordinated debt | - | 250,000 |
| Repayment of subordinated debt | (200,000) | - |
| Issuance of long-term debt | 250,000 | - |
| Repayment of long-term debt | (300,000) | - |
| Deferred financing costs on long-term debt | (1,786) | - |
| **Cash used in financing activities** | (90,231) | (32,975) |
| (Decrease)/increase in cash and cash equivalents | (46,786) | 32,258 |
| Cash and cash equivalents - beginning of period | 50,403 | 18,145 |
| **Cash and cash equivalents - end of period** | $ 3,617 | $ 50,403 |
| **Supplementary information** | | |
| Interest paid | $ 48,269 | $ 39,259 |
| Income taxes paid | $ 11,256 | $ - |

The accompanying notes are an integral part of these consolidated financial statements.

## 1. Organization and Nature of Business

EnerCare Solutions Inc. ("EnerCare Solutions") is the successor to The Consumers' Waterheater Operating Trust (the "Trust"). EnerCare Solutions is a wholly-owned subsidiary of EnerCare Inc. ("EnerCare"). EnerCare Solutions converted into a dividend paying corporation on January 1, 2011, pursuant to a plan of arrangement under the Canadian Business Corporations Act. The conversion was accounted for on a continuity of interest basis, with the net reduction in the Trust subordinated debt being reflected as a contribution to equity along with the assumption of certain of its obligations.

EnerCare holds all of the issued and outstanding shares of EnerCare Solutions. EnerCare Solutions, through its wholly owned subsidiaries, owns a portfolio of water heaters and other assets which are primarily rented to customers across Ontario ("Rentals").

The head office of EnerCare Solutions is located at 4000 Victoria Park Avenue, Toronto, Ontario, M2H 3P4.

## 2. Basis of Preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of financial statements. EnerCare Solutions has consistently applied the same accounting policies throughout all periods presented as if these policies had always been in effect.

The policies applied in these consolidated financial statements are based on IFRS issued and outstanding as of February 27, 2013, the date the board of directors approved the consolidated financial statements. The board also has the authority to amend the consolidated financial statements after they have been issued.

## 3. Significant Accounting Policies

The significant accounting policies used in the preparation of these consolidated financial statements are described below.

*Basis of Measurement*

The consolidated financial statements have been prepared under a historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value, including derivative instruments.

*Consolidation*

The consolidated financial statements of EnerCare Solutions consolidate the accounts of its subsidiaries. All inter-company transactions, balances and unrealized gains and losses from inter-company transactions are eliminated on consolidation.

Subsidiaries are those entities which EnerCare Solutions controls by having the power to govern the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable are considered when assessing whether EnerCare Solutions controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by EnerCare Solutions and are de-consolidated from the date that control ceases. As of the date of these consolidated financial statements, 100% of the operating results and equity of the subsidiaries is attributable to EnerCare Solutions.

*Business Combinations*

Business combinations are presented in accordance with IFRS 3. Identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values. Any excess purchase price over the identifiable net assets will be recorded as goodwill. Acquisition-related costs are expensed in the periods in which the costs are incurred and the services are received.

*Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand, deposits held with banks, and short-term investments with maturities of less than 90 days after the date of purchase.

*Financial Instruments*

Financial assets and liabilities are recognized when EnerCare Solutions becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and EnerCare Solutions has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation is eliminated or EnerCare Solutions is no longer required to transfer economic resources to a third party in respect of the obligation.

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, EnerCare Solutions classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired for the purpose of selling or repurchasing in the short-term.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of income. Gains and losses arising from changes in fair value are presented in the statement of income within other gains and losses in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the statement of financial position, which is classified as non-current.

(ii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. EnerCare Solutions' loans and receivables are comprised primarily of trade receivables, dividends receivable and cash and cash equivalents, and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest rate method less a provision for impairment.

(iii) Financial liabilities at amortized cost: Financial liabilities at amortized cost include trade payables, related party payable, provisions, dividend payable, other liabilities, interest payable, bank debt and long-term debt. Trade payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are recognized at amortized cost using the effective interest rate method. Bank debt and long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest rate method.

Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

*Impairment of Financial Assets*

At each reporting date, EnerCare Solutions assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, EnerCare Solutions recognizes an impairment loss on financial assets carried at amortized cost as the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

*Trade Receivables*

Trade receivables are carried at original invoice amount less any provisions for doubtful debts. Provisions are made where there is evidence of a risk of non-payment, taking into account ageing, previous experience and general economic conditions. When a trade receivable is determined to be uncollectable it is written off, firstly against any provision available and then to the income statement.

Subsequent recoveries of amounts previously provided for are credited to the statement of income.

*Provisions*

Provisions for legal claims, where applicable, are recognized in other liabilities when EnerCare Solutions has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. The discount rate, if applied, would be the risk free rate at the then measurement date. EnerCare Solutions performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

*Equipment*

Equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Costs include expenditures that are directly attributable to the acquisition of the asset, including installation costs, labour, and direct overhead. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to EnerCare Solutions and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of income during the period in which they are incurred.

The major categories of equipment are depreciated over the estimated useful lives of the assets on a straight-line basis as follows:

| | |
|---|---|
| Water heaters | 16 years |
| Furniture and fixtures | 5 years |
| Computer equipment | 3 years |
| Computer software | 2-10 years |

Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of loss on disposal of equipment in the statement of income.

*Leases*

Leasing agreements which transfer to EnerCare Solutions substantially all the benefits and risks of ownership of an asset are treated as finance leases, as if the asset had been purchased outright. Assets held under finance leases are depreciated on a basis consistent with similar owned assets or the lease term if shorter. The interest element of the finance lease is included in the statement of income. All other leases are operating leases and the rental costs are charged to the statement of income on a straight-line basis over the lease term.

*Intangible Assets*

Intangible assets are predominantly related to contractual customer relationships and customer contracts acquired in business combinations that are recognized at fair value at the acquisition date. The contractual customer relationships and customer contracts have a finite useful life and are carried at cost less accumulated amortization and impairment charges. Amortization is calculated using the straight-line method over the expected life of 16 years.

*Impairment of Non-financial Assets*

Intangible assets and equipment are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purposes of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or "CGU"). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. When there are indications of a potential decrease in a prior period impairment loss a reversal may be recognized through profit and loss. A change in amortization may be required based upon the estimated remaining service life.

*Income Tax*

EnerCare Solutions uses the liability method to determine the deferred income tax liability and related earnings impact. Under this method, deferred income tax assets and liabilities are determined based on differences between the accounting and tax value of assets and liabilities and are measured using the currently enacted, or substantially enacted, tax rates that will be in effect when the differences are anticipated to reverse. Deferred income tax assets are recognized to the extent that it is probable that the assets can be recovered.

Income tax comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in equity, in which case income tax is also recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted, or substantially enacted, at the end of the reporting period, and any adjustment to tax payable in respect to previous years.

Deferred income tax assets and liabilities are presented as non-current.

*Revenue*

Revenue is recognized when it is probable that the economic benefits will flow to EnerCare Solutions and delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. These criteria are met at the time the equipment is installed and, depending on the delivery condition, title and risk have been passed to the customer and acceptance of the product, when contractually required, has been obtained. Revenue is measured based on the contract price, net of discounts at the time of sale.

The Rental business earns revenue based on the rental agreements that are managed under: (a) the co-ownership agreement with Direct Energy Marketing Limited ("DE") as well as (b) other third party arrangements. Under the co-ownership agreement with DE, EnerCare Solutions earns 65% of gross revenues, and the remaining 35% is earned by DE for installing and servicing the equipment. For all other portfolio assets that are not under the co-ownership agreement EnerCare Solutions recognizes 100% of the revenues, together with related operating and service costs.

*Interest Expense and Financing Charges*

Interest charges on debt are classified as an operating activity. Costs associated with the arrangement of long-term financing are netted against the carrying value of the debt and amortized on an effective interest rate method over the expected term of the debt.

*Hedge Accounting*

In 2009, EnerCare Solutions completed a series of cash flow hedge transactions which resulted in a charge to other comprehensive income. This loss is being amortized into income using the effective interest rate method based upon the maturity of the 6.20% $60,000, Series 2009-1 Senior Unsecured Notes (the "2009-1 Notes") and the 6.75% $270,000 Series 2009-2 Senior Unsecured Notes (the "2009-2 Notes" and collectively with the 2009-1 Notes, the "2009 Notes"). The Series 2009-1 Notes matured in April 2012.

*Dividends*

Dividends on shares are recognized in EnerCare Solutions' consolidated financial statements in the period in which the dividends are approved by EnerCare Solutions' board of directors.

*Critical Accounting Estimates and Judgments*

EnerCare Solutions makes estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from those estimates. The following items are of significance for the period.

*DE Earnings Items*

DE, through Enbridge Gas Distribution Inc. ("EGD"), provides billing and collection services for substantially all of EnerCare Solutions' water heaters and other assets. In September 2009, DE implemented a billing system conversion which coincided with a billing system conversion by EGD. Further, in late 2011, DE began utilizing a third party billing system for new assets and in August 2012 also employed the billing system for non-EGD territory accounts. EnerCare Solutions' internal controls over financial reporting ("ICFR") identified issues principally associated with DE's original system conversion as well as the third party conversion, primarily in respect of completeness of billing, customer collections and allocation of customer payments.

At December 31, 2011, EnerCare Solutions estimated and recorded revenue accruals of $1,700 in respect of billings and adjustments expected to be recovered from customers, but did not include any amounts that EnerCare Solutions may recover from DE for lost revenues arising from the billing system conversion. At December 31, 2012, EnerCare Solutions has accrued approximately $800 in respect of outstanding billing amounts. The accrual decreased during the fourth quarter of 2012 as a result of the implementation of the new non-EGD territory billing system.

Buyout processing from 2010 remains outstanding. EnerCare Solutions has recorded amounts expected to be charged to customers by DE and continues to work with DE to resolve issues relating to buyout processing.

Settlement with DE for an amount in excess of revenues recorded and recovery of any expenses accrued would result in an increase to previously stated EBITDA amounts.

*Accounting Standards Issued but not yet Applied*

IFRS 9, *Financial Instruments*, was issued in November 2009. It addressed classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return on investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with early adoption permitted. EnerCare Solutions has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 10, *Consolidated Financial Statements,* was issued in May 2011. It introduces a single model in the control analysis to determining which investees should be consolidated. The consolidation procedures are carried forward from IAS 27 (2008). The control model is based on three elements: An investor controls an investee when (1) it is exposed or has rights to variable (e.g. residual) returns from its involvement with that investee, (2) has the ability to affect those returns through its power over that investee and (3) there is a link between power and returns. The approach comprises a series of indicators of control, but no hierarchy is provided: preparers are required to analyze all facts and circumstances and apply their judgment in making the control assessment. Control is usually assessed over a legal entity, but also can be assessed over only specified assets and liabilities of an investee. In such a case that portion of the investee is a deemed separate entity (referred to as a silo) for the purpose of applying the consolidation requirements. In assessing control, the investor also needs to analyze substantial potential voting rights as well as currently exercisable potential voting rights. This is likely to change the control conclusion in some cases: currently exercisable potential voting rights might not be considered substantive and vice versa. Control is assessed on a continuous basis, i.e. it is reassessed as facts and circumstances change considerably. This standard is required to be applied for accounting periods beginning on or after January 1, 2013. EnerCare Solutions has reviewed the standard and has determined that it will not have an impact on current reporting.

IFRS 13, *Fair Value Measurement*, was issued in May 2011. It defines “fair value” and sets out, in a single IFRS, a framework for measuring fair value measurements. IFRS 13 applies when other IFRSs require or permit fair value measurements. It does not introduce any new requirements to measure an asset or liability at fair value, nor does it change what is measured at fair value in IFRSs or address how to present changes in fair value. This standard is required to be applied for accounting periods beginning on or after January 1, 2013, but can, with early adoption permitted. EnerCare Solutions has reviewed the standard and has determined that it will not have an impact on current reporting.

## 4. Cash and Cash Equivalents

| As at December 31, | **2012** | 2011 |
| --- | --- | --- |
| Cash at bank and in hand | **$3,617** | $12,438 |
| Short-term deposits | **-** | 37,965 |
| Ending balance | **$3,617** | $50,403 |

## 5. Accounts Receivable

| As at December 31, | **2012** | 2011 |
| --- | --- | --- |
| Accounts receivable (net of provision) | **$16,384** | $19,638 |
| Bad and doubtful debt provision: | | |
| Opening balance | **$ 486** | $ 112 |
| Charge for the period | **1,061** | 374 |
| Provision ending balance | **$ 1,547** | $ 486 |

## 6. Accounts Payable and Accrued Liabilities

| As at December 31, | **2012** | 2011 |
| --- | --- | --- |
| Accounts payable | **$ 8,238** | $14,455 |
| Accruals | **1,289** | 2,984 |
| Compensation payable | **1,519** | - |
| Current taxes payable | **8,020** | 5,380 |
| Other payables | **68** | - |
| Ending balance | **$19,134** | $22,819 |

## 7. Capital Assets

| | Water Heaters | Other | Total |
|---|---|---|---|
| ***At December 31, 2010:*** | | | |
| Cost | $773,440 | $174 | $773,614 |
| Accumulated depreciation | (333,334) | (24) | (333,358) |
| Net book value | 440,106 | 150 | 440,256 |
| Additions | 60,503 | 176 | 60,679 |
| Loss on disposal before proceeds | (23,031) | - | (23,031) |
| Depreciation for the period | (55,253) | (55) | (55,308) |
| At December 31, 2011 | $422,325 | $271 | $422,596 |
| ***At December 31, 2011:*** | | | |
| Cost | $782,854 | $350 | $783,204 |
| Accumulated depreciation | (360,529) | (79) | (360,608) |
| Net book value | 422,325 | 271 | 422,596 |
| Additions | 57,885 | (8) | 57,877 |
| Acquisitions (note 21) | 1,944 | - | 1,944 |
| Loss on disposal before proceeds | (20,527) | - | (20,527) |
| Depreciation for the period | (50,781) | (87) | (50,868) |
| At December 31, 2012 | $410,846 | $176 | $411,022 |
| ***At December 31, 2012:*** | | | |
| Cost | $791,775 | $342 | $792,117 |
| Accumulated depreciation | (380,929) | (166) | (381,095) |
| Net book value | $410,846 | $176 | $411,022 |

## 8. Intangible Assets

| | |
|---|---|
| ***At December 31, 2010:*** | |
| Cost | $743,336 |
| Accumulated depreciation | (367,316) |
| Net book value | 376,020 |
| Amortization for the year | (46,395) |
| At December 31, 2011 | 329,625 |
| ***At December 31, 2011:*** | |
| Cost | $743,336 |
| Accumulated depreciation | (413,711) |
| Net book value | $329,625 |
| Amortization for the year | (46,393) |
| At December 31, 2012 | 283,232 |
| ***At December 31, 2012:*** | |
| Cost | 743,336 |
| Accumulated depreciation | (460,104) |
| Net book value | $283,232 |

## 9. Debt

***Current and long term debt:***

| As at December 31, | 2012 | 2011 |
|---|---|---|
| Current portion of long term debt: | | |
| Opening balance January 1: | **$ 60,000** | $ - |
| Current portion of non-current debt | **-** | 60,000 |
| Repayment of debt | **(60,000)** | - |
| **Total current portion** | **$ -** | $ 60,000 |
| | | |
| Non-current portion of long term debt: | | |
| Senior debt principal amount | **$510,000** | $570,000 |
| Deferred financing costs and interest accretion | **(1,946)** | (3,147) |
| Opening balance January 1 | **$508,054** | $566,853 |
| | | |
| Current portion of long-term debt | **$ -** | $ (60,000) |
| Repayment of debt | **(240,000)** | - |
| Issuance of debt | **250,000** | - |
| Additional deferred financing costs | **(1,786)** | - |
| Amortization of deferred financing costs | **1,240** | 1,201 |
| **Total non-current portion** | **$517,508** | $508,054 |
| | | |
| Senior debt principal amount | **$520,000** | $510,000 |
| Deferred financing costs and interest accretion | **(2,492)** | (1,946) |
| **Total long term debt** | **$517,508** | $508,054 |

Under its revolving credit facility, which matures on January 28, 2014, EnerCare Solutions had a standby charge of 0.375%. EnerCare Solutions is subject to three principal financial covenants as defined in the loan documents. The covenants address interest and debt coverage. At December 31, 2012, EnerCare Solutions complied with these covenants and is able to fully utilize the revolver limit of $35,000. As at December 31, 2012, no amounts had been drawn on this revolver.

The long term debt balance includes the following items:

The senior debt consists of the 2009-2 Notes maturing on April 30, 2014 and the $250,000 4.30% 2012-1 Senior Unsecured Notes (the “2012 Notes”) maturing on November 30, 2017, with semi-annual interest payments due on April 30 and October 30 and May 30 and November 30 in each year. The 2009-1 Notes matured and were repaid with cash on hand on April 30, 2012. The $240,000 5.25% 2010-1 Senior Unsecured Notes were redeemed in December 2012, including a make-whole payment of $1,920, from proceeds of the 2012 Notes.

## 10. Long Term Subordinated Promissory Note

On January 1, 2011, the $381,755 Series 1 subordinated debt outstanding to EnerCare was redeemed for additional equity consideration and the issuance of a $100,000 subordinated promissory note. On September 28, 2012, a $150,000 promissory note was issued by EnerCare (collectively, the “Subordinated Promissory Notes”). The Subordinated Promissory Notes bear interest at rates notified by the holder. The notes have no fixed repayment terms, but are redeemable at the option of EnerCare Solutions at a price equal to the principal amount thereof plus accrued and unpaid interest to the date of redemption. The notes have been classified as long term as there are no near term intentions to demand repayment.

## 11. Subordinated Debt

On July 6, 2011, through a series of transactions, EnerCare Solutions invested $250,000 in preferred shares of Stratacon Inc. ("Stratacon"), a subsidiary entity of EnerCare. On January 1, 2012, 1759857 Ontario Limited, Stratacon and EnerCare Connections Inc. amalgamated. The name of the amalgamated entity is EnerCare Connections Inc. ("ECI"). The investment was funded through a short term bank loan. The preferred shares accrue cumulative dividends at 6.90% and are both redeemable and retractable. Stratacon, now ECI, invested the proceeds by providing a loan to a subsidiary of EnerCare Solutions ("Intercompany Loan"). The Intercompany Loan is a demand loan and bears interest at 7.00% (the "Subordinated Debt"). The subsidiary used the proceeds from the loan to repay existing obligations due to EnerCare Solutions from the subsidiary. On July 1, 2012, $200,000 of the preferred shares were redeemed and EnerCare Solutions used the proceeds to pay down the Intercompany Loan. Both the preferred shares and the Intercompany Loan have been classified as short term due to their underlying features.

## 12. Income Taxes

Income tax expense is recognized based on management's best estimates of the weighted average annual income tax rate for the full financial year. The estimated average annual rate used for the year ended December 31, 2012 and 2011 was 26.50% and 28.25%, respectively. The provisions for income taxes in the consolidated statements of earnings reflect an effective rate that differs from the combined Canadian federal and provincial rates, as follows:

| For the year ended December 31, | **2012** | 2011 |
|---|---|---|
| Tax expense at statutory rate of 26.50% (2012) and 28.25% (2011) | **$ (522)** | $(1,300) |
| Tax effects of: | | |
| Future tax rate differential | **6,359** | (3,437) |
| Non-deductible expenses | **(1,577)** | 1,056 |
| Other | **60** | (644) |
| **Total** | **$4,200** | $(4,325) |
| | | |
| Current tax expense | **13,896** | 5,380 |
| Deferred income tax recovery | **(9,696)** | (9,705) |
| **Total tax expense/(recovery)** | **$4,200** | $(4,325) |

The provision for income taxes in 2012 reflects both a provision for temporary difference expected to be reversed in the future and the impact of future changes in tax rates applicable to EnerCare Solutions. The statutory tax rate of 26.50% reflects the reduction of corporate tax rates in the province of Ontario.

**Long-term deferred income tax asset and liability**

The deferred income tax asset and liability on EnerCare Solutions' statement of financial position reflect the estimated tax on temporary and other differences. The movement of the deferred income tax accounts are as follows:

| As at December 31, | **2012** | 2011 |
|---|---|---|
| As at January 1: | **$(143,038)** | $(152,743) |
| Charge to the statement of income | **9,696** | 9,705 |
| Total | **$(133,342)** | $(143,038) |

EnerCare Solutions' management expects that the future tax assets will be recoverable based on the expected profitability of the company.

The balance of the deferred income tax asset and liability classified by temporary differences is as follow:

| As at December 31, | 2012 | 2011 |
|---|---|---|
| **Deferred tax asset** | | |
| Financing fees | **$ 348** | $ 485 |

| | | |
|---|---|---|
| **Deferred tax liability** | | |
| Equipment | **(109,616)** | (117,372) |
| Temporary difference due to different tax year ends | **(24,205)** | (25,877) |
| Other | **131** | (274) |
| | **(133,690)** | (143,523) |
| **Total** | **$(133,342)** | $(143,038) |

## 13. Share Capital

| As at December 31, | | 2012 | | 2011 |
|---|---|---|---|---|
| Shares Issued and Outstanding | **Shares** | **Net Proceeds** | Shares | Net Proceeds |
| Opening balance at January 1 | **1,001** | **$79,614** | 1,001 | $79,614 |
| Issued | **-** | **-** | - | - |
| Totals | **1,001** | **$79,614** | 1,001 | $79,614 |

EnerCare Solutions' articles of incorporation provide for the issuance of an unlimited number of common shares. On January 1, 2012, EnerCare Solutions converted to a corporation pursuant to a plan of arrangement. As at December 31, 2012, there were 1,001 common shares issued and outstanding.

## 14. Commitments

Under operating lease agreements for office equipment, EnerCare Solutions is required to make annual minimum lease payments. The aggregate amount of future minimum payments is as follows:

| As at December 31, | 2012 | 2011 |
|---|---|---|
| Due 2013 | **$ 255** | $ 305 |
| Due 2014 | **255** | 248 |
| Due 2015 | **370** | 248 |
| Due 2016 | **392** | 363 |
| Due 2017 | **70** | 386 |
| Thereafter | **-** | 64 |
| Total commitments under non-cancellable operating leases | **$1,342** | $1,614 |

The operating lease payments recognized in the consolidated statement of income for 2012 is $309 (2011 - $604).

## 15. Contingent Liabilities

EnerCare Solutions has been named in legal proceedings commenced by certain competitors seeking specified and unspecified damages based on allegations that EnerCare Solutions, its service provider, EcoSmart Home Services Inc., and others engaged in unlawful surveillance and other activities aimed at tracking the door to door sales efforts of the competitors.

EnerCare Solutions is a party to a number of product liability claims and lawsuits in the ordinary course of business. Management is of the opinion that any liabilities that may arise from these lawsuits have been adequately provided for in these consolidated financial statements.

## 16. Financial Instruments

The main risks EnerCare Solutions' financial instruments are exposed to include credit risk, liquidity risk and market risk.

### Credit Risk

EnerCare Solutions is exposed to credit risk on accounts receivable from customers. EnerCare Solutions' credit risk is considered to be low.

EnerCare Solutions' financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts receivable. For less than 5% of its installed assets, EnerCare Solutions is exposed to credit risk in the normal course of business for customers who are billed by DE or are billed by EGD outside their service territory. For accounts receivable from customers billed on EGD invoices within their service territory, EnerCare Solutions is guaranteed payment by EGD for 99.42% of the amount billed (subject to certain exceptions) 21 calendar days after the invoices are issued. A related trust agreement also serves to mitigate EnerCare Solutions' credit exposure on receivables owing from EGD.

There are no amounts that are past due nor impaired that have not been provided for.

### Liquidity Risk

EnerCare Solutions believes it has low liquidity risks given the makeup of its accounts payable and accrued liabilities, related party payables, provisions, dividends payable, other liabilities, interest payable. EnerCare Solutions measures liquidity risk through comparisons of current financial ratios with the financial covenants contained in its revolving and term loan credit facility agreements, Master Trust Indenture and Supplemental Trust Indentures as applicable. To reduce liquidity risk, EnerCare Solutions has maintained financial ratios which comply with the financial covenants applicable to the borrowings and has staggered its senior debt maturity dates through to November 30, 2017.

The covenants under the 2009 Notes and 2012 Notes are contained in a Master Trust Indenture, and Supplemental Trust Indentures effective January 29, 2010 and November 21, 2012, respectively. Under the terms of these indentures, EnerCare Solutions may not incur additional senior debt other than certain refinancing debt and certain working capital debt if the incurrence test is less than 3.8 to 1. The incurrence test is the ratio of defined EBITDA over defined interest expense calculated 12 months in arrears. EnerCare Solutions exceeded this threshold requirement at December 31, 2012.

The summary of financial obligations and contractual maturities related to undiscounted non-derivative financial liabilities excluding accounts payable was as follows:

| Period | Principal Payments | Interest Payments |
|---|---:|---:|
| Due in 2013 | $ - | $28,975 |
| Due in 2014 | 270,000 | 19,863 |
| Due in 2015 | - | 10,750 |
| Due in 2016 | - | 10,750 |
| Due in 2017 | 250,000 | 10,750 |
| Thereafter | - | - |
| Total | $520,000 | $81,088 |

## Market Risk

*Fair Value*

The carrying values of cash and cash equivalents, accounts receivable, bank indebtedness, accounts payable and accrued liabilities approximate their fair values due to their relatively short periods to maturity.

The following table presents the carrying amounts and the fair values of EnerCare Solutions' financial assets and liabilities at December 31, 2012 and December 31, 2011. The estimated fair values of the financial instruments are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

| As at December 31, | **2012** | | 2011 | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Value** | Carrying Value | Fair Value |
| Cash and cash equivalents | **$ 3,617** | **$ 3,617** | $ 50,403 | $ 50,403 |
| Trade and other receivables | **16,384** | **16,384** | 28,098 | 28,098 |
| Total financial assets | **$ 20,001** | **$ 20,001** | $ 78,501 | $ 78,501 |
| Financial liabilities measured at amortized cost: | | | | |
| Gross senior borrowings | **$520,000** | **$537,274** | $570,000 | $591,717 |
| Long term Subordinated Promissory Notes | **250,000** | **250,000** | 100,000 | 100,000 |
| Subordinated Debt | **50,000** | **50,000** | 250,000 | 250,000 |
| Total borrowings | **820,000** | **837,274** | 920,000 | 941,717 |
| Trade and other payables | **29,273** | **29,273** | 43,876 | 43,876 |
| Total financial liabilities | **$849,273** | **$866,547** | $963,876 | $985,593 |

The fair value of the Subordinated Promissory Notes and the Subordinated Debt was not determinable, as no quoted market price exists for these instruments because they were not traded in an active and liquid market.

## Capital Risk Management

EnerCare Solutions' capital management strategy is designed to maintain financial strength and flexibility to support profitable growth in all business environments. EnerCare Solutions' continually monitors its capital management strategy and makes adjustments as appropriate. EnerCare Solutions' capital management strategy, objectives, evaluation measures, definitions and targets have not changed significantly from the prior year.

EnerCare Solutions was in compliance with all covenants under the 2009 Notes, 2012 Notes and revolver as at December 31, 2012.

### 17. Selling, General and Administrative

| For the year ended December 31, | **2012** | 2011 |
|---|---|---|
| Employee compensation and benefits | **$ 6,458** | $ 7,174 |
| Professional fees | **3,741** | 3,201 |
| Selling, office and other | **5,792** | 6,035 |
| Billing and servicing | **6,313** | 6,702 |
| Claims and bad debt | **5,275** | 3,345 |
| Total | **$27,579** | $26,457 |

### 18. Provisions

On a regular basis, EnerCare Solutions evaluates key accounting estimates based upon historical information, internal and external factors and probability factors to measure provisions. The key provision is on account of claims as a result of water damage caused by faulty water heaters. The claims provision is a current liability estimated as the product of the average anticipated dollar loss and the current and anticipated incidents.

| As at December 31, | **2012** | 2011 |
|---|---|---|
| Opening balance: | **$1,592** | $2,728 |
| Charged/(credited) to the consolidated statement of income: | | |
| Additional provision | **3,503** | 3,719 |
| Reversals | **(876)** | (1,167) |
| Claims spending during the period | **(3,493)** | (3,688) |
| | **$ 726** | $1,592 |

All claims generated during the years ended are typically paid out within 12 months, therefore no discounting in the provisions have been calculated.

### 19. Changes in Working Capital

The following table reconciles the changes in working capital during the comparative periods as presented in the consolidated statement of cash flows.

| For the year ended December 31, | **2012** | 2011 |
|---|---|---|
| Accounts and other receivables | **$11,714** | $(9,188) |
| Prepaid and other assets | **(107)** | (750) |
| Accounts payable and accrued liabilities | **(10,790)** | 8,971 |
| Provisions | **(866)** | (1,136) |
| Interest payable | **(3,105)** | 8,541 |
| Equity movement | **-** | (173) |
| Total | **$(3,154)** | $ 6,265 |

### 20. Related Parties and Transactions with DE

*Key Management*

Key management includes EnerCare Solutions' officers and directors. External director's fees are included in professional fees as part of total selling, general and administrative expenses. Total compensation and benefits to key management for employee services is shown below:

| For the year ended December 31, | **2012** | 2011 |
|---|---|---|
| Salaries and short-term benefits | **$2,906** | $1,720 |
| Other employment benefits | **66** | 112 |
| Long term benefits | **1,046** | 1,433 |
| Total | **$4,018** | $3,265 |

EnerCare often incurs expenses on behalf of EnerCare Solutions in the normal course of business. Related party amounts owing to EnerCare are typically on account of selling, general and administrative expenses.

*Related party payables*

| As at December 31, | **2012** | 2011 |
|---|---|---|
| Related party payables | **$1,936** | $459 |

*Transactions with DE*

EnerCare Solutions' relationship with DE is significant, as DE services and supports more than 90% of EnerCare Solutions' customers and installed asset base. The following agreements govern the principal affairs between EnerCare Solutions and DE.

***Co-ownership Agreement:***

Under this agreement, DE receives, subject to certain exceptions, 35% of the gross revenue generated by the co-owned portfolio of assets and is obligated to service that asset portfolio, effectively operating the day-to-day activities of that portion of the business. Pursuant to an agreement between DE and EnerCare, DE is entitled to put forth one individual for consideration by EnerCare Solutions' board for inclusion in EnerCare's annual management information circular for election as a director of EnerCare and its subsidiaries, including EnerCare Solutions, for as long as it is servicer under the co-ownership agreement.

***Origination Agreement:***

Under this agreement, subject to certain exceptions, DE must offer to sell all rental water heaters to EnerCare Solutions at prescribed prices, essentially at DE's cost plus an inventory service fee and a set installation fee. EnerCare Solutions has no obligation to purchase any water heaters. The agreement also establishes an incentive fee payable to DE should certain growth targets be achieved. The initial term of the origination agreement is through December 2022 and is subject to extension or early termination in certain circumstances.

***Other Agreements with DE:***

In addition to the above agreements, EnerCare Solutions and DE have entered into an agreement for the servicing of Toronto Hydro Energy Services Inc. ("TH") Energy units, as these units are not subject to the co-ownership agreement. This agreement provides for the administration and servicing of the portfolio on a fee-for-service basis.

EnerCare Solutions and DE have also entered into an agreement for the origination and servicing of HVAC rental units, whereby DE originates HVAC rental customers and provides servicing to these HVAC rental customers. EnerCare Solutions has the right to originate HVAC rental customers outside of this arrangement with DE.

Details of amount paid or payable to DE are as follows:

| For the year ended December 31, | **2012** | 2011 |
|---|---|---|
| Origination agreement: | | |
| Capital expenditures | **$49,089** | $53,159 |
| GreenSource acquisition | **1,944** | - |
| Inventory service fee | **3,150** | 3,386 |
| Other capital expenditures | **5,418** | 5,272 |
| Other expenses, including billing and servicing costs | **2,850** | 2,918 |
| Total | **$62,451** | $64,735 |

## 21. Acquisition of Water Heaters from GreenSource Capital Inc.

On February 29, 2012, EnerCare Solutions acquired approximately 3,421 water heaters and HVAC equipment from GreenSource Capital Inc., a subsidiary of DE, for cash consideration of $2,053, with $5 in acquisition costs being expensed. During the third quarter of 2012, EnerCare Solutions completed the process of determining the fair values of the assets that were acquired. This analysis resulted in a reduction of the original purchase price by $109, and determined the fair value of the net assets acquired is entirely allocated to equipment with a fair value for $1,944.

The rental revenue from GreenSource is not subject to the Co-ownership Agreement between EnerCare Solutions and DE. Rental revenue and profit in the fourth quarter of 2012, related to GreenSource, was approximately $221 and $99, and $705 and $227, respectively, year to date. EnerCare Solutions entered into a transitional services agreement with DE to provide service support to customers on a fee-for-service basis.

## 22. Other Income

Other income of $1,138 includes amounts recognized in the current year related to prior years' events. The amount for 2012 includes approximately $1,500 on account of a settlement reached by EnerCare Solutions and DE on account of billing disputes for water heater installation costs, $200 from DE on account of billing shortfalls and a reduction of $600 related to reversal of billed amounts from EGD following the billing conversions.

## 23. Subsequent Events

On January 28, 2013, EnerCare Solutions entered into a $60,000 term credit facility (the "Term Loan") with the Canadian chartered bank affiliate of National Bank Financial Inc. The Term Loan is payable interest only until maturity in January 2016 and is payable in whole or in part at any time without penalty. The Term Loan bears interest at a rate of bankers' acceptances plus 120 basis points or prime plus 20 basis points at EnerCare Solutions' current credit rating. EnerCare Solutions drew the full amount available under the Term Loan on February 4, 2013. The covenants under the Term Loan mirror those of the existing $35,000 Revolver.

On February 1, 2013, EnerCare Solutions completed a public offering of $225,000 aggregate principal amount of 4.60% Series 2013-1 Senior Unsecured Notes due February 3, 2020 (the "2013 Notes"). The 2013 Notes were sold at a price of 99.94% of the principal amount, with an effective yield of 4.61% per annum if held to maturity. The covenants associated with this debt are the same as those under the existing 2009-2 Notes and 2012 Notes.

The proceeds of the offering and the drawdown of the Term Loan will be used to redeem on March 6, 2013 the outstanding $270,000 aggregate principal amount of 6.75% Series 2009-2 Senior Unsecured Notes due April 30, 2014 for an aggregate redemption price of approximately $290,095, which includes interest and a make-whole payment of $13,754.

On February 26, 2013, the revolving credit agreement pricing was amended to reflect a 20% reduction in standby fees on the unused portion of the facility and a 30 basis point reduction in margin on borrowings at EnerCare Solutions' current debt ratings.