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

The following discussion and analysis of financial condition and results of operations for the years ended December 31, 1998 and 1997 should be read in conjunction with the audited combined financial statements and related notes of the Regulated Utility Subsidiaries.

The audited combined financial statements have been prepared by combining the audited financial statements of the Regulated Utility Subsidiaries (refer to Note 1 to the audited combined financial statements). Transactions between segments have been eliminated in all reporting of the combined financial information.

Results of Operations

Combined Operations

Segmented revenues and earnings attributable to Class A and Class B shares for the years 1997 and 1998 were as follows:

	Revenues		**Earnings**	
	1998	1997	**1998**	1997
	(Millions of Canadian Dollars)			
Regulated natural gas operations	**882.1**	916.2	**68.7**	67.3
Regulated electric operations	**676.1**	665.1	**86.5**	84.2
Intersegment eliminations	**(1.4)**	(1.4)	**0.1**	0.1
Combined	**1,556.8**	1,579.9	**155.3**	151.6

Interest expense for 1998 increased by $3.7 million to $141.2 million. This increase was primarily due to new financing in natural gas operations, partially offset by the refinancing of maturing debt at lower rates.

Dividends on retractable preferred shares for 1998 decreased by $0.6 million to $18.0 million primarily as a result of the redemption of $68.1 million of retractable preferred shares on December 1, 1998. Dividends on non-retractable equity preferred shares for 1998 decreased by $2.0 million to $6.4 million primarily as a result of the redemption and refinancing of $109.5 million of non-retractable equity preferred shares at lower dividend rates in October 1997, partially offset by a reclassification of $56.9 million of retractable preferred shares to non-retractable equity preferred shares on December 1, 1998.

Income taxes for 1998 increased by $10.4 million to $156.8 million. The increase was primarily due to higher earnings before income taxes.

Regulated Natural Gas Operations

Earnings from regulated natural gas operations for 1998, which amounted to 44.3% of combined earnings of the Corporation, increased by $1.4 million to $68.7 million. Temperatures in 1998 were 3.2% warmer than normal, whereas temperatures in 1997 were 1.0% warmer than normal.

Revenues in 1998 decreased by $34.1 million to $882.1 million. The primary reason for the decrease was lower natural gas supply costs recovered in customer rates, lower sales per customer, and the impact of warmer temperatures which were 1.3% warmer than in 1997, partially offset by customer growth.

Operating expenses for 1998 decreased by $46.8 million to $613.1 million. This decrease was primarily due to lower natural gas supply costs. These costs decreased primarily due to lower natural gas prices, lower sales per customer and warmer weather. These decreased costs were partially offset by customer growth. The amount of natural gas supply costs recorded as an expense is based on the forecast cost of natural gas included in customer rates. Any variances from forecast are deferred until the AEUB approves revised rates to either refund or collect the variance. As a consequence, changes in natural gas supply costs have a negligible effect on the Corporation's earnings.

Regulated Electric Operations

Earnings from regulated electric operations for 1998, which amounted to 55.7% of combined earnings of the Corporation, increased by $2.3 million to $86.5 million.

Revenues in 1998 increased by $11.0 million to $676.1 million. This increase was primarily the result of higher sales to the Alberta power pool and higher industrial sales, mainly in the oilfield sector, partially offset by higher refunds to customers resulting primarily from the 1998 negotiated settlement for ATCO Electric.

Operating expenses for 1998 increased by $2.2 million to $297.9 million. The increase was primarily due to higher maintenance costs and higher costs of fuel and purchased power, partially offset by lower general and administrative costs.

Fuel costs in ATCO Electric are mostly for coal supply. To protect against volatility in coal prices, ATCO Electric owns or has committed under long term contracts sufficient coal supplies for the anticipated lives of its coal-fired generating plants. These contracts are at prices that are either fixed or indexed to inflation.

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, preferred shares and common equity. Short term borrowings and short term bank loans are used to provide flexibility in the timing and amounts of long term financing.

Cash flow from operations increased by $17.7 million to $353.1 million in 1998. Investing increased from $242.2 million in 1997 to $243.5 million in 1998. Investment in property, plant and equipment decreased by $1.5 million to $273.3 million in 1998.

To finance 1998 operations, including the redemption of $51.7 million of long term debt having interest rates ranging from 8.37% to 12.00% and $68.1 million of preferred shares having a dividend rate of 5.90%, the Corporation incurred $164.7 million of short term borrowings from CU and incurred $20.0 million of bank borrowings.

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

On February 10, 1999, Dominion Bond Rating Service Limited ("DBRS") announced it had assigned preliminary ratings on the Corporation's long term debt and commercial paper at AA (low) and R-1 (middle), respectively. On July 5, 1999, CBRS Inc. ("CBRS") announced it had assigned ratings on the Corporation's debentures, commercial paper and preferred shares at A+, A-1(High) and P-1, respectively, and that the outlook on the Corporation's securities is negative. CBRS indicated that the negative outlook primarily reflects the uncertainty related to the proposed change from traditional rate of return regulation to the power purchase arrangements and the evolving dynamics of the energy industry which may introduce some volatility in the Corporation's overall earnings and coverage ratios in the future.

Future income tax liabilities of $57.4 million at December 31, 1998, 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

The Corporation's operations are subject to the normal risks faced by regulated companies. These risks include the approval by the AEUB of customer rates which permit a reasonable opportunity to recover on a timely basis the estimated costs of providing service, including a fair return on rate base. The Corporation's ability to recover the actual costs of providing service and to earn the approved rates of return depends on achieving the forecasts established in the rate-setting process.

The business risks of ATCO Electric have changed with the implementation of the EUA in 1996. The risks include increased forecast risk as each electric utility is exposed to the forecasts of other electric utilities in Alberta as well as the requirement to independently forecast province-wide generation output and pool prices. These risks have been mitigated in the 1999 negotiated settlement for ATCO Electric by the implementation of deferral accounts for pool transactions. For generation, these accounts permit the deferral of 100% of the variations from forecast pool prices and 90% of the variations from forecast volumes. For distribution, these accounts permit the deferral of 100% of the variations from forecast pool prices. The balances in these deferral accounts at the end of 1999 and 2000, respectively, will be passed to customers.

There will be further changes in the electric utility industry in Alberta. Through legislation passed in 1998, the government of Alberta has set a timetable to pursue a direction, similar to that developing in other jurisdictions, whereby generation is completely deregulated and retail competition is available. This will result in changes to ATCO Electric's business risk, both at the generation level and in the distribution and retail businesses.

Hedging

It is the policy of the Corporation to use financial instruments to reduce specific risk exposures and not to hold these instruments for trading purposes.

The Corporation has entered into several contracts in order to reduce interest rate, foreign exchange and commodity price risk. The financial impact of these contracts is not material and the counterparty in each transaction is a major financial institution or a significant industry participant.