

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31, 2004**

Results of Operations

The accompanying financial information reflects the operating results of the Authority and LIPA for the three months ended March 31, 2004 and March 31, 2003.

Change in Net assets (deficit)

The change in net deficit for the three months ended March 31, 2004 totaled approximately \$81 million compared with \$66 million for the three months ended March 31, 2003. The variation of \$15 million resulted primarily from increased fuel expense recognition due in part to higher fuel costs coupled with the impact of the change in the FPPCA, as discussed below.

Revenue

Revenue for the three months ended March 31, 2004, increased approximately \$48 million when compared to the similar period in 2003. The increase is primarily attributable to system load growth totaling approximately \$16 million, higher recoveries of excess fuel costs totaling approximately \$38 million offset by the negative effects of weather totaling approximately \$6 million.

Fuel and Purchased Power Costs

Fuel and purchased power costs increased approximately \$45 million. This increase is due in part to higher currently recognized excess fuel costs totaling approximately \$8 million, higher excess fuel cost recoveries of approximately \$38 million, and higher sales volumes of approximately \$5 million. These increases were partially offset by approximately \$6 million, due to the impact of the FPPCA modification whereby 2004 mark-to-market unrealized gains or losses are deferred. For the three month period ended March 31, 2003, such unrealized amounts were included in net income.

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment (“FPPCA”). During 2003, the FPPCA was modified to allow LIPA to recover from customers amounts incurred for fuel and purchased power beyond those included in base rates (“Excess Fuel Costs”) in the period incurred, as opposed to a deferral method. This modification was fully implemented on January 1, 2004. From that date forward, LIPA will recover an amount of Excess Fuel Costs necessary to achieve revenue in excess of expenses of \$20 million annually.

Effective with the Board's adoption of the 2004 budget in mid-February, the FPPCA surcharge was increased by 4.5%. The revised surcharge is designed to provide sufficient recovery of Excess Fuel Costs across the year for LIPA to achieve revenue in excess of expenses of \$20 million by year-end. However, due to the mid-February start date of the increased surcharge and the seasonal nature of LIPA's sales, Excess Fuel Costs incurred through March have been temporarily deferred, and will be recovered by year end. The FPPCA surcharge will be adjusted periodically throughout the year, if necessary, to ensure recovery of sufficient excess fuel and purchased power costs to meet the net income target of \$20 million.

During the three months ended March 31, 2004, Excess Fuel Costs totaled approximately \$154 million. Of this amount, \$57 million has been billed to customers and approximately \$36 million remains deferred for collection over the remainder of the year. The remaining \$61 million was charged to expense, as LIPA's forecast supported a net income figure of \$20 million with that level of expense through March 31, 2004.

During the three months ended March 31, 2003, Excess Fuel Costs totaled \$130 million. Of the \$130 million of 2003 excess, LIPA collected in March, \$2 million of the \$75 million to be collected through year-end. Of the remaining \$128 million, \$76 million was deferred for collection over the 10-year period to begin January 1, 2004. The remaining \$52 million was charged to expense, as LIPA's forecast supported a net income figure of \$20 million with that level of expense through March 31, 2003.

After eliminating the effects of the FPPCA and unrealized gains/losses, fuel and purchased power costs in 2004 increased by approximately \$29 million when compared to the three months period ended March 31, 2003. Approximately \$5 million is attributable to increased sales for the 2004 period compared to 2003, and the balance is attributable to increased fuel and purchased power prices.

Operations and maintenance ("O&M")

O&M increased approximately \$13 million for the three month period March 31, 2004 compared to the similar period in 2003. This increase is primarily attributable to lower capital expenditures covered by the MSA totaling approximately \$7 million, increased PSA costs totaling \$3 million due to property tax increases, increased customer accounts expense totaling approximately \$1 million, the timing of clean energy expenses totaling \$1 million, and increased NMP2 costs totaling approximately \$1 million.

Depreciation and amortization

Depreciation and amortization increased slightly due to higher utility plant balances in 2004 when compared to 2003.

Other Income

Other income decreased approximately \$1 million compared to last year due primarily to a decrease in the sale of emission credits. Also contributing to the decrease was lower investment income as a result of lower investment balances in 2004 when compared to 2003.

Interest Charges and Credits

Interest charges on long term debt increased slightly when compared to 2003 as a result of the unwinding of the variable rate swap on Series L debt, the issuance of Series 2003C bonds partially offset by savings resulting from 2003 refinancings.

Other Significant Items

During the three months ended March 31, 2004, the Authority issued \$100 million of commercial paper to reimburse the Authority's treasury for capital projects that had been funded with cash from operations. This issuance is primarily responsible for the decrease in net assets invested in capital assets net of related debt of approximately \$114 million. As a result of this issuance, total commercial paper outstanding is \$200 million.

Balance Sheet
(Thousands of Dollars)

	March 31, 2004 (unaudited)	December 31, 2003 (audited)
Current assets:		
Cash and cash equivalents	\$ 239,009	\$ 219,095
Investments	191,670	198,892
Accounts receivable (less allowance for doubtful accounts of \$19,485)	216,299	235,732
Other accounts receivable	23,965	24,978
Fuel inventory	58,846	54,651
2004 Fuel and purchased power costs recoverable	36,615	-
Material and supplies inventory	7,491	7,130
Interest receivable	297	602
Prepayments and other current assets	5,659	5,836
Total Current Assets	779,851	746,916
Noncurrent assets:		
Utility plant and property and equipment, net	3,397,221	3,390,387
Promissory notes receivable-KeySpan Energy	155,425	155,425
Nonutility property and other investments	81,583	63,652
Deferred loss related to non fuel derivatives	71,055	39,139
Deferred charges	90,328	80,431
Regulatory assets		
Shoreham settlement	575,086	575,660
Fuel and purchased power costs	355,716	381,880
Total regulatory assets	930,802	957,540
Acquisition adjustment (net of accumulated amortization of \$818,381 and \$790,211, respectively)	3,277,130	3,305,300
Total assets	\$ 8,783,395	\$ 8,738,790
Current liabilities:		
Short-term debt	\$ 200,000	\$ 100,000
Current maturities of long-term debt	186,380	186,380
Current portion of capital lease obligation	79,732	80,073
Accounts payable and accrued expenses	315,048	329,971
Accrued payments in lieu of taxes	13,651	38,552
Accrued interest	80,224	42,000
Customer deposits	25,141	25,252
Total current liabilities	900,176	802,228
Noncurrent liabilities:		
Long-term debt	6,843,110	6,835,943
Capital lease obligation	712,969	721,630
Asset retirement obligation	65,419	64,452
Deferred credits	153,957	147,679
Swaption	156,495	133,757
Claims and damages	20,273	21,481
Total noncurrent liabilities	7,952,223	7,924,942
Net assets (deficit):		
Invested in capital assets net of related debt	(679,860)	(566,082)
Unrestricted	610,856	577,702
Total net (deficit) assets	(69,004)	11,620
Total liabilities and net (deficit) assets	\$ 8,783,395	\$ 8,738,790

**Statement of Revenues, Expenses and
Changes in Net Assets (Deficit)
(Thousands of Dollars)**

	Three Months Ended March 31,	
	2004 (unaudited)	2003 (unaudited)
Operating revenues - electric sales	\$ 599,159	\$ 550,709
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	336,166	314,094
Recovery of Prior Year Excess Fuel Costs	8,978	25,678
Fuel and purchased power expenses - deferral, net	<u>(36,615)</u>	<u>(76,633)</u>
	308,529	263,139
Operations and maintenance	188,657	175,813
General and administrative	9,345	9,324
Depreciation and amortization	57,035	54,884
Payments in lieu of taxes	<u>50,285</u>	<u>50,575</u>
Total Operating Expenses	<u>613,851</u>	<u>553,735</u>
Operating Loss	<u>(14,692)</u>	<u>(3,026)</u>
Nonoperating revenues and expenses:		
Other income, net		
Investment income	1,946	2,682
Carrying charges on regulatory asset	7,765	7,497
Other	<u>3,651</u>	<u>4,292</u>
Total other income, net	<u>13,362</u>	<u>14,471</u>
Change in net assets before interest charges (credits)	<u>(1,330)</u>	<u>11,445</u>
Interest charges and (credits):		
Interest on long-term debt, net	74,032	72,386
Other interest	6,252	6,093
Allowance for borrowed funds used during construction	<u>(990)</u>	<u>(1,135)</u>
Total interest charges	<u>79,294</u>	<u>77,344</u>
Change in net deficit	(80,624)	(65,899)
Net assets (deficit)		
Total net assets (deficit), beginning of year	11,620	(11,253)
Cumulative effect of change in accounting principle	<u>-</u>	<u>2,873</u>
Total net deficit, end of period	<u>\$ (69,004)</u>	<u>\$ (74,279)</u>

**Statement of Cash Flows
(Thousands of Dollars)**

	Three Months Ended March 31,	
	2004 (unaudited)	2003 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 643,158	\$ 591,384
Paid to suppliers and employees		
Operations and maintenance	(213,756)	(246,312)
Fuel and purchased power	(350,444)	(303,447)
Payments in lieu of taxes	(94,147)	(94,953)
Net cash used in operating activities	<u>(15,189)</u>	<u>(53,328)</u>
Investing activities:		
Net purchases (sales) of investment securities	7,222	(37,816)
Earnings received on investments	1,512	2,904
Other	3,311	-
Net cash provided by investing activities	<u>12,045</u>	<u>(34,912)</u>
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(44,660)	(42,949)
Insurance proceeds	-	747
Swaption proceeds	-	21,643
Proceeds of promissory note redemption	-	461,345
Interest paid, net	(32,282)	(17,611)
Proceeds from the issuance of commercial paper notes	100,000	-
Redemption of long-term debt	-	(461,345)
Net cash provided by (used in) capital and related financing activities	<u>23,058</u>	<u>(38,170)</u>
Net increase (decrease) in cash and cash equivalents	19,914	(126,410)
Cash and cash equivalents at beginning of period	219,095	491,986
Cash and cash equivalents at end of period	<u>\$ 239,009</u>	<u>\$ 365,576</u>
Reconciliation to net cash provided by operating activities:		
Operating loss	\$ (14,692)	\$ (3,026)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	57,035	54,884
Nuclear fuel burned	949	1,542
Shoreham surcharge recovery	8,339	(16,093)
Provision for claims and damages	1,749	2,625
Change in the fair market value of fuel related derivatives	-	6,778
Accretion of asset retirement obligation	967	912
Other	(1,692)	(2,057)
Changes in operating assets and liabilities:		
Accounts receivable, net	20,446	29,041
Fuel and Material & supplies inventory	(4,556)	(18,916)
Fuel and purchased power costs recovered related to prior periods	8,978	25,619
Excess fuel and purchased power costs deferred	(36,615)	(76,573)
Prepaid assets	177	(365)
Accounts payable and accrued expenses	(16,160)	(28,643)
Accrued taxes	(24,901)	(29,501)
Other, net	(15,213)	445
Net cash used in operating activities	<u>\$ (15,189)</u>	<u>\$ (53,328)</u>