Q. (a) With reference to Hydro's response to CA-177-NLH, when will the updating of Hydro's five-year financial projection be completed?

(b) Is there any reason to believe, with the figures in this updated five-year financial projection and a reasonable forecast of interest rates through 2010, that Hydro will not be able to make an estimate of its annual embedded cost of debt for its regulated business for the years 2008, 2009, and 2010?

A. (a & b) Hydro’s financial projection for its regulated activities is attached.

NEWFOUNDLAND AND LABRADOR HYDRO

Regulated Activities
Financial Projection

2007 to 2011

October 2006

Executive Summary

This document outlines Newfoundland and Labrador Hydro's (Hydro's) financial projection for the regulated segment of its business for the period 2007 to 2011. The highlights are:

- The year 2007 is based on the Test Year as filed with the Board of Commissioners of Public Utilities (the Public Utilities Board) in August, 2006, as part of Hydro's 2006 General Rate Application (GRA), with adjustments to reflect recent changes to Rate Stabilization Plan (RSP) customer balances, 2007 dividend payments, and Hydro's October 2006 bond issue.

- Rates established for 2007 are expected to remain in effect until the end of 2008. A rate increase is anticipated for January 1, 2009 to maintain Hydro's regulated return on rate base within the range approved by the Public Utilities Board. However, the actual decision to proceed with a rate application for 2009 would not occur until such time as more detailed forecast information is available.

- For 2007 and 2009, the target rates of return on regulated equity have been established at the Province's projected marginal cost of borrowing of 5.2% and 7.0% respectively.

- Based on a dividend payout ratio of 25% commencing in 2008, Hydro's debt-to-capital ratio is projected to improve from 83% at the end of 2007 to 78% by the end of 2011. Based on the existing debt-to-capital target ratio of 80%, Hydro recognizes the possibility of additional dividend payments toward the end of this projection period.

- Operating and maintenance expenses are predicted to increase by the rate of inflation, and also incorporate annual adjustments for System Equipment Maintenance at Holyrood.

- Holyrood No. 6 fuel prices are anticipated to remain in the $55 to $57/bbl price range over the period 2007 to 2011.

- Hydro anticipates additional power purchases from wind generation in each of the years 2008, 2009, and 2010.

- In 2011, the combined balances in the RSPs are projected to be $9 million, comprised of $12 million owing from customers, offset by a $3 million credit in the Hydraulic Variation Account.

- Capital expenditures are projected to be $216 million during the period. There are no generation plant additions planned during the period covered by this projection. Only the expenditures for 2007 have received detailed scrutiny from Hydro's Leadership Team. Expenditures for other years are preliminary and subject to changes in scope and timing.

- A debt issue of $200 million has been forecast during the period, primarily to replace a debt issue maturing in 2008.

- Average compound growth of 1.5% is forecast in energy sales to Newfoundland Power, and 2% in total regulated energy sales over the period.

- Including the effects of the Rate Stabilization Plan, annual average rates to Newfoundland Power are projected to be 9% lower in 2009 than projected for 2007. For Island Industrial customers, 2009 rates are projected to be 9% higher than those projected for 2007.

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Introduction

Purpose

This report outlines the financial results for the regulated segment of Hydro based on the assumptions and hypotheses outlined on the following pages. This financial projection was prepared for internal management use and accordingly may not be appropriate for general or other purposes.

This financial projection has been prepared to:

- assess the rate of progress towards financial targets;
- identify the potential need for rate increases over the forecast period; and
- update Hydro's Leadership Team on the short-term outlook for the regulated business.

The forecast is intended to provide management with a directional, high-level view over the forecast period and does not represent budget or cost of service level detail.

Scope

The information provided for the years 2007 to 2011 is based on Hydro's short-term load and power purchases forecasts prepared in May 2006. The load forecast reflects the complete closure of the Abitibi Consolidated Inc. (ACI) Stephenville mill in 2008 and includes a new Island Industrial customer Voisey's Bay Nickel commencing in 2011. The power purchases forecast includes provision for new wind energy purchases on the Island Interconnected system in each of the years 2008, 2009 and 2010. Fuel prices are based on a May, 2006 forecast, and for No. 6 fuel incorporate 1% sulphur content. Capital cost information incorporates Hydro's 2007 Capital Budget filed with the Public Utilities Board.

The information provided for 2007 is based on the Test Year as filed with the Public Utilities Board in August 2006, with the following exceptions:

- RSP balances have been adjusted to reflect December, 2006 estimates filed with the Public Utilities Board in October, 2006. These estimates incorporate a $10 million payment from the Provincial Government toward the Industrial Customers' historical RSP balance;
- Hydro's dividend payments reflect a 25% payout commencing April 1, 2008; and
- The coupon rate for Hydro's 2006 bond issue of $225 million has been updated to 4.3% from the 5% originally forecast.

Hydro believes the financial results and rates for 2007 in this projection fairly reflect the above changes, but a detailed cost of service study has not yet been prepared which incorporates these changes. As well, detailed cost of service studies have not been prepared for the remaining years covered by this projection. Forecasts for all years were prepared using Hydro's other computerized planning models.

For the purpose of providing regulated financial information, non-regulated revenues, expenses, assets, liabilities, and equity have been removed. These include activities related to:

- Investment in Churchill Falls (Labrador) Corporation Limited (CF(L)Co);
- Lower Churchill Development;
- Business Development activities;
- Sales to the mining industry in Labrador West; and
- Export Sales.

For the purpose of this regulated projection, no new activity has been assumed for non-regulated items after 2007[1]. While Hydro is aware that there will be additional non-regulated expenditures, they have been excluded from this regulated projection.

Future Oriented Financial Information

The financial projection reflects certain future oriented financial information that involves substantial known and unknown risks and uncertainties, some of which are beyond Hydro's control. Hydro's actual results, performance or achievement will differ from those expressed in, or implied by, this financial projection and these differences could be material. Accordingly, no assurances can be given that the events anticipated by this projection will transpire or occur.

[1] Hydro has however continued with its treatment of debt and equity associated with its investment CF(L)Co.

Background

Goals and Objectives

Hydro is a crown corporation committed to providing cost-effective and reliable energy services to our customers for the benefit of all people of the Province of Newfoundland and Labrador (the Province). Our skilled and committed employees will use innovative methods and technologies, and will maintain high standards of safety and health, and environmental responsibility.

During 2005, the Provincial Government re-affirmed Hydro's status as a Provincial crown corporation and announced an expanded mandate for Hydro to include the petroleum and alternative energy sectors of the energy industry. In November 2005, the Province issued an Energy Plan Discussion Paper seeking public input to shape the future of the Province's energy policy. The resulting public consultation will assist in forming a long-term energy policy for the Province.

In support of its expanded mandate, Hydro has reorganized and created new business units for the Lower Churchill Project and for New Business Development. These initial steps reflect Hydro's corporate plan that includes sanction and commencement of construction on the Lower Churchill, investments in oil and gas and Labrador wind, and increased capacity supplied through wind power purchases. An overview of Hydro's strategic planning process is attached as **Appendix A**. Details of Hydro's corporate plan pertaining to regulated activities are contained in **Appendix B**.

Electricity Market Environment

Hydro's planning and financial performance is predicated on a number of market factors and economic assumptions, as they affect the electric power industry's operating environment, most significantly:

- the provincial electricity market which determines the level of Hydro's sales;
- world fuel prices; and
- borrowing costs.

The general levels of economic activity in the Province, including the operating levels of locally based firms competing in international markets, directly affect Hydro's performance.

The Province has recorded solid growth in GDP since the late 1990's with resource developments factoring prominently as sources of economic gain. While the trend is positive, primarily due to offshore oil production, the Province's pulp and paper industry continues to face challenges, as evidenced by the 2005 closure of the ACI Stephenville mill. Personal income growth and employment have, however, been sustained during this period. This income growth, combined with low interest rates, resulted in strong consumer spending and housing demand. Also noteworthy during 2005, was that the Voisey's Bay nickel development concluded major construction activities and commenced its respective operations phase.

Electricity has remained the space heating energy of choice in the majority of new residential and commercial construction. High heating fuel oil prices in recent years have served to increase electricity demand by further increasing the installation preference for electric heat and encouraging the substitution of fuel oil heating systems.

Over the next few years, Hydro's operating environment is expected to be generally positive. High energy prices are encouraging offshore exploration and development options. Residential and nonresource commercial investment remains strong. The Province's tourism industry continues to show good growth.

The importance of the fishery harvesting and processing sectors continues for a great many rural areas of the Province but there appears to be some broadening concern for the sustainability and/or economic viability of the key crustacean fisheries. Ground fish stocks have yet to commercially recover and landings remain at historically low levels. More favourable aspects of the fishery rest with aquaculture developments, secondary processing operations and market niche development. Excluding newsprint manufacturing, the Province's existing heavy industry base of oil refining and iron ore mining and processing is enjoying strong market prices and high operating levels and some material expansion in the iron ore industry appears possible. On the Island, a new base metal mine is under development and further gold mining is expected. The Provincial Government's financial position has improved significantly owing to favourable oil prices and a restructured Atlantic Accord.

With an overall economic environment continuing to benefit from relatively low interest and inflation rates, the underlying local market conditions for electric power operations suggest modest growth potential through the medium term of five to ten years. Medium-term electricity requirements in the Province remain positive despite some weakness and restructuring in a number of its traditional resource sectors.

Regulatory Activities

Existing rates for Hydro's customers reflect the Public Utilities Board Order No. P.U. 14 (2004) (P.U. 14) dated May 4, 2004, which were implemented July 1, 2004. Since that time, revenue-neutral rate changes have occurred to implement rate structure changes for Newfoundland Power, and to phase in uniform rates for Hydro's Rural Labrador Interconnected customers. In 2008, it is anticipated that the phase-in of uniform rates for Rural Labrador Interconnected customers will be completed.

At the date of this projection, Hydro had the following outstanding applications under consideration by the Public Utilities Board:

- the 2006 General Rate Application;
- the 2007 Capital Budget Application;
- the final disposition on an application for rates to be charged to Aur Resources; and
- an application to defer and amortize extraordinary repairs to Unit #2 at Holyrood.

Relevant Legislation

Relevant legislation governing Hydro's activities include the:

- Public Utilities Act (http://www.gov.nl.ca/hoa/statutes/p47.htm)
- Electrical Power Control Act, 1994 (http://www.gov.nl.ca/hoa/statutes/E05-1.htm)
- Hydro Corporation Act (http://www.gov.nl.ca/hoa/statutes/h16.htm)

Relevant Contracts and Agreements

There are power purchase agreements with the following non-utility generators (NUGs):

- Star Lake Hydro Partnership;
- Algonquin Power Inc. (Rattle Brook);
- Corner Brook Pulp and Paper Limited; and

- Exploits River Hydro Partnership.

Hydro anticipates additional power purchases from wind generation in each of the years 2008, 2009 and 2010.

General Assumptions and Hypotheses

General assumptions and hypotheses are as follows:

- No major changes will occur with respect to accounting policies for Hydro. As part of Hydro's 2006 GRA, it has been proposed that changes in its depreciation policy be reviewed at a subsequent hearing. Impacts associated with these proposed changes have not been included in this projection.
- No major changes will occur with respect to current legislation governing Hydro that would affect regulated activities.
- Other key financial assumptions are presented in **Table 1** following.

Table 1: Key Financial Data

	2007	2008	2009	2010	2011
Fuel Purchase Prices					
No. 6 ($ per Barrel)	55.98	56.80	56.55	54.75	57.35
Diesel ($ per gallon)	2.69	2.39	2.32	2.25	2.32
Interest Rates					
Short-term	4.19%	4.04%	4.57%	4.56%	4.65%
Long-term	5.20%	5.24%	6.99%	6.98%	7.07%
Debt guarantee fee	1.00%	1.00%	1.00%	1.00%	1.00%
Inflation Rates	1.30%	1.50%	1.60%	1.70%	1.70%
Target Return on Equity	5.20%	-	6.99%	-	-

Fuel Prices:

For 2007 to 2011, fuel prices were obtained from PIRA Energy Group, May 2006 forecasts for No. 6 Fuel with 1.0% sulphur content.

Interest and Inflation Rates:

For 2007 rates were developed from averages of forecasts from various investment dealers provided in May, 2006. For 2008, interest rates were based on average investment dealer forecasts provided for the fourth quarter of 2007. After 2008, interest rate assumptions are derived from a current long-term Conference Board of Canada projection (Antunes, 2006).

Target Return on Equity:

In accordance with P.U. 14 (2004), target rates of return on regulated equity have been established at the Province's projected marginal cost of borrowing for the forecast test years.

Specific Assumptions and Hypotheses

Fixed Assets and Capital Expenditures

Fixed asset balances and associated depreciation expenses are provided in the Financial Statements. Capital expenditures are presented in **Table 2**.

Table 2: Capital Expenditures ($000,000)

Year	Amount
2007	41.8
2008	46.6
2009	44.2
2010	41.4
2011	42.4
Total	216.4

The capital expenditures in the years beyond 2007 have not been subject to the full rigor of Hydro's capital budget process and as a result, the timing, scope, and amount of these proposals may differ from what will eventually be included in Hydro's capital budgets in those years.

Rate Stabilization Plan and No. 6 Fuel

Purchase prices for No. 6 fuel during the forecast period are shown in **Table 1**, and serve as the base against which market variations will be captured in the RSP. Holyrood's thermal efficiency factor is estimated at 630 kWh/barrel of No. 6 fuel for the period 2007 to 2011 and hydraulic production is based on the full historic hydraulic production record.

The RSP is financed at Hydro's Test Year weighted average cost of capital.

Projected customer RSP balances and the balances in the Hydraulic Variation Account are shown in **Table 3**.

Table 3: Combined RSP Balances ($000,000)

	2007	2008	2009	2010	2011
Newfoundland Power	7.2	(10.3)	(6.3)	(9.2)	1.4
Island Industrial	0.2	(1.5)	(0.4)	(0.2)	11.2
Hydraulic Variation Account	(10.9)	(8.2)	(6.1)	(4.6)	(3.4)
Total	(3.4)	(19.9)	(12.8)	(14.0)	9.2

The Hydraulic Variation Account has no new variations for the projection period, and is being gradually reduced and assigned to customers. The balance in the Industrial plan for 2011 is due to incremental fuel costs associated with additional Industrial load in that year.

Energy Sales

Table 4 shows projected energy sales over the forecast time horizon. The 2011 increase in Island Industrial load reflects the new load requirement from Voisey's Bay Nickel Company Limited for a hydrometallurgical processing facility on the Island portion of the Province.

Table 4: Electricity Sales by Customer Class
(GWh)

	2007	2008	2009	2010	2011
Island Interconnected:					
Newfoundland Power	4,964.0	4,982.6	5,064.8	5,159.6	5,258.7
Island Industrial:					
Firm	894.3	873.6	889.3	889.3	1,107.5
Nonfirm	4.9	8.4	8.4	8.4	21.7
Rural	359.3	359.0	362.4	364.5	365.8
Total Island	6,222.5	6,223.6	6,324.9	6,421.8	6,753.7
Labrador Interconnected:					
CFB Goose Bay	77.4	75.9	74.5	73.0	71.2
Rural	482.8	487.1	494.3	500.3	500.3
Total Labrador	560.2	563.0	568.8	573.3	571.5
Rural Isolated	63.7	64.4	65.2	66.0	66.7
Total	6,846.4	6,851.0	6,958.9	7,061.0	7,392.0

Operating and Administration Expenses

Excluding extraordinary items, operating and administration expenses for 2007 onward are assumed to increase at the rate of inflation. Extraordinary items have been projected for Holyrood based on a 10-Year Maintenance Plan filed with the Public Utilities Board in July, 2006. **Table 5** shows normal operating expenses on a kWh basis for the projection period.

Table 5: Operating Expenses

	2007	2008	2009	2010	2011
Operating Costs ($ 000)	92,431	91,832	94,437	96,534	97,206
Sales (GWh)	6,846.4	6,851.0	6,958.9	7,061.0	7,392.0
$ / kWh	0.0135	0.0134	0.0136	0.0137	0.0132

Production and Power Purchases

Holyrood's thermal efficiency factor has been set at 630 kWh per barrel of No. 6 fuel, and the forecast for hydraulic generation incorporates the full hydrological record of reservoir inflows.

Existing NUGs on the Island Interconnected system included in the current supply forecast are Star Lake, Algonquin Power Inc., Corner Brook Pulp and Paper cogeneration project and Exploits River Hydro Partnership projects. Rural Isolated purchases include purchases from Hydro-Québec for the L'Anse au Loup system, and wind energy from Frontier Power Systems Inc. for Ramea.

In October 2006, Hydro, through a competitive bidding process, selected NeWind Group Inc. to supply 25 MW of wind power from its St. Lawrence Wind Project to the Island Interconnected system. Supply from this project is anticipated to commence in October 2008. Hydro has also issued a new Request for Proposals for additional 25 MW blocks of wind power. In this projection, a second 25 MW purchase is forecast for the Fall of 2009, and a third 25 MW purchase is forecast for the Fall of 2010.

Hydro's production and power purchase requirements are provided in **Table 6**. These production levels, supplemented by power purchases, are necessary to meet the projected energy sales provided in **Table 5**.

Table 6: Electricity Production and Power Purchases (GWh)

	2007	2008	2009	2010	2011
Hydraulic					
Bay d'Espoir	2,649.0	2,649.0	2,649.0	2,649.0	2,649.0
Hinds Lake	317.0	317.0	317.0	317.0	317.0
Upper Salmon	569.0	569.0	569.0	569.0	569.0
Cat Arm	668.0	668.0	668.0	668.0	668.0
Granite Canal	221.0	221.0	221.0	221.0	221.0
Paradise River	41.0	41.0	41.0	41.0	41.0
Mini Hydro	7.1	7.1	7.1	7.1	7.1
Total Hydraulic	4,472.1	4,472.1	4,472.1	4,472.1	4,472.1
Other					
Holyrood Thermal	1,599.7	1,571.2	1,573.1	1,570.0	1,838.0
Gas Turbines	3.4	3.4	3.4	3.4	3.8
Diesel	53.9	54.5	55.1	55.7	56.3
Total Other	1,656.9	1,629.1	1,631.6	1,629.1	1,898.1
CF(L)Co	675.5	679.3	685.6	691.1	689.1
Rural Isolated Purchases	17.6	17.9	18.1	18.4	18.6
Non-Utility Generators	414.9	444.0	547.1	650.2	724.8
Total Power Purchases	1,108.0	1,141.2	1,250.8	1,359.7	1,432.5
Total Production and Power Purchases	7,237.0	7,242.4	7,354.5	7,460.8	7,802.7

Financial Management Strategy

Financial Objectives

It is the public policy of the Province that the rates charged by Hydro, as an energy producer and retailer:

> . . . should provide sufficient revenue to the producer or retailer of the power to enable it to earn a just and reasonable return as construed under the *Public Utilities Act* so that it is able to achieve and maintain a sound credit rating in the financial markets of the world . . . (Electrical Power Control Act, 1994, Part I, 3[a][iii])

In addition, Hydro must conduct its business activities in such a manner:

> . . . that would result in power being delivered to consumers in the province at the lowest possible cost consistent with reliable service . . . (Electrical Power Control Act, 1994, Part I, 3[b][iii])

This financial projection includes the following targets:

- Rates are designed to achieve target returns on regulated equity for 2007 and 2009 of 5.2% and 7.1% respectively, consistent with the 2004 PUB order allowing a rate of return on regulated equity based on the Province's marginal cost of long-term debt.

  While Hydro is considering the factors raised by the Public Utilities Board in P.U. 14 in connection with obtaining an investor-owned utility comparable return on equity, no changes have been incorporated in this projection.

- Forecast new debt maturities are at a weighted average term to maturity (WATM) currently targeted between 12.5 and 15 years.

- For the purposes of this projection, Hydro's dividend payout is 25% of net operating income, commencing April 1, 2008.

Long-Term Debt

Once the promissory notes balance in any given year reaches $300 million, Hydro is required to issue long-term debt. Within the limitations of Hydro's long-term financial model which forecasts cash requirements annually, promissory note balances have been restricted to $150 million at the end of each year. Given these guidelines, Hydro anticipates issuing $200 million in debt during 2008 to replace matured issue Series AA. This excludes any new long-term debt issues to finance unregulated capital expenditures.

The denomination and features of the new debt issue, although provided on a forecast basis in the explanatory notes to the enclosed financial statements, will ultimately be subject to the capital market conditions at the time of issue.

Return on Equity

Rate of return on equity for Hydro is based on net income, relative to Hydro's average regulated equity. **Table 7** presents rates of return on equity and net income for 2007 through 2011.

Table 7: Return on Equity

Year	Return on Equity (Percent)	Net Income ($ 000,000)
2007	4.8	10.3
2008	3.9	8.7
2009	6.9	16.0
2010	7.8	19.3
2011	7.9	20.5

In 2007 and 2009, Hyrdro's target returns on equity (5.2% and 7.0%, respectively) differ from the returns on equity in **Table 7** for those years due primarily to the exclusion of return on equity on Rural assets.

Return on Rate Base

Hydro's return is regulated using a rate of return on rate base methodology. Under this methodology, a weighted average cost of capital is applied to rate base to calculate a regulated return. Rate of return on rate base is regulated net income plus regulated net interest including the debt guarantee fee, relative to Hydro's average rate base. In 2004, the Public Utilities Board approved a range of rate of return on rate base of 30 basis points, and defined excess earnings as earnings that exceed 15 basis points beyond the Test Year rate of return on rate base.

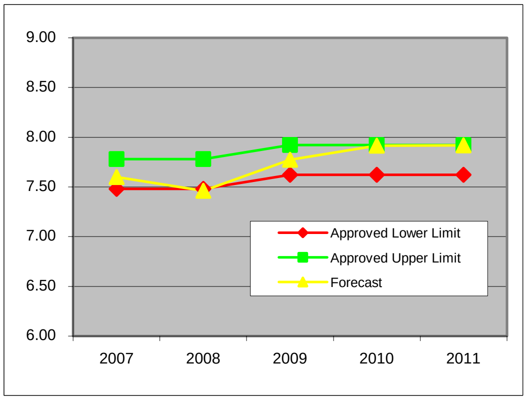
In 2010 and 2011, excess earnings are projected to be $2.3 million and $5.9 million respectively, resulting primarily from net fuel savings associated with increased wind purchases, and lower net interest expense due to an increase in sinking fund interest earned. These amounts have been recorded as a reduction in revenues and set up as a liability on the Balance Sheet. For the purposes of this projection, no disposition has been assumed.

Table 8 shows regulated returns on rate base for 2007 to 2011. **Figure 1** presents Hydro's forecast rate of return on rate base relative to the range of return on rate base approved by the Public Utilities Board.

Table 8: Return on Rate Base

	Regulated Return ($ 000,000)			Return on Rate Base (Percent)	
Year	Net Income	Net Interest	Total	Current Year	Test Year
2007	10.3	103.1	113.3	7.60	7.63
2008	8.7	102.6	111.3	7.46	7.63
2009	16.0	100.3	116.3	7.77	7.77
2010	19.3	98.5	117.8	7.92	7.77
2011	20.5	96.7	117.1	7.92	7.77

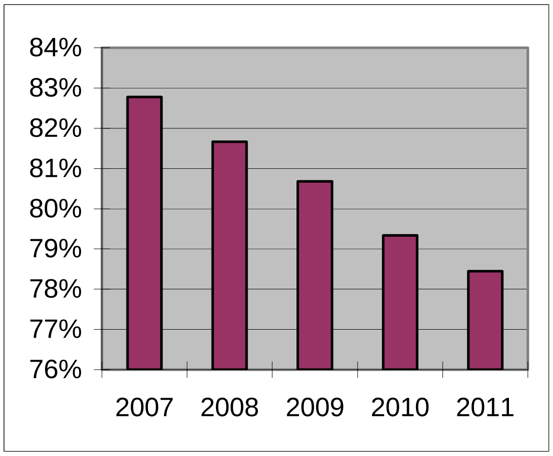
Figure 1: Rates of Return on Rate Base (Percentage)



Debt-to-Capital

Figure 2 depicts regulated debt as a percent of total capital for the period 2007 to 2011.

Figure 2: Debt to Capital



Rates

This financial projection is prepared on the basis that 2007 and 2009 are Test Years, meaning that rates for regulated customers will be adjusted in each of those years to recover the regulated revenue requirement. Detailed cost of service studies have not been prepared; however, rates have been estimated with Hydro's planning model that uses simplifying assumptions. Projected rates and rate changes are believed to be indicative based on the assumptions used but not as precise as if detailed cost of service studies were available. Average mill rates are presented in **Table 9**. Rates for Newfoundland Power and Island Industrial customers exclude the effects of the RSP; other rates are as outlined.

Table 9: Average Rates by Customer Class
(mills/kWh)

	2007	2008	2009	2010	2011
Island Interconnected Rates					
Newfoundland Power	66.4	66.6	68.5	69.1	69.6
Island Industrial	49.3	49.3	50.2	50.2	50.2
Island Rural Interconnected (1)	110.5	106.4	103.8	105.3	104.2
Labrador Interconnected Rates					
Department of National Defense	58.8	55.8	52.1	50.6	50.6
Labrador Rural Interconnected	30.1	32.6	32.9	32.9	32.9
Rural Isolated Rates (1)	165.0	158.8	154.9	157.2	155.6

(1) Includes RSP adjustments at the retail level

Table 10 presents rates for Newfoundland Power and Island Industrial customers after RSP adjustments.

Table 10: Newfoundland Power and Island Industrial Rates
After RSP Adjustment
(mills/kWh)

	2007	2008	2009	2010	2011
After RSP Adjustment (Jan 1)					
Newfoundland Power	73.2	72.7	66.5	67.2	69.3
Island Industrial	44.5	49.6	48.5	49.0	50.3

The reduction in rates evident in 2009 for Newfoundland Power is due to the elimination of its December, 2003 (Historical) RSP balance. However, an increase is projected for Island Industrial customers as a result of the elimination of the large credit in the Industrial current RSP due to the closure of ACI Stephenville.

Pro-Forma Regulated Financial Statements

Regulated Balance Sheets

Regulated Income Statements

Regulated Cash Flow Statements

Pro-Forma Regulated Balance Sheets

	2007	2008	2009	2010	2011
For the years ended December 31					
($ 000,000)					
ASSETS					
FIXED ASSETS					
Property, plant, and equipment	1,363.4	1,365.5	1,364.3	1,361.7	1,357.9
CURRENT ASSETS					
Accounts receivable	61.7	55.7	57.7	58.7	61.0
Fuel and Supplies	34.6	52.4	51.3	49.5	48.9
Prepaid expenses	2.2	2.2	2.3	2.3	2.3
Total current assets	98.5	110.3	111.3	110.5	112.1
RATE STABILIZATION PLAN	(3.4)	(19.9)	(12.8)	(14.0)	9.2
DEFERRED CHARGES (Note 2)	85.1	79.7	74.4	69.9	66.2
TOTAL ASSETS	1,543.6	1,535.6	1,537.2	1,528.0	1,545.5
LIABILITIES AND SHAREHOLDER'S EQUITY					
LONG-TERM DEBT (Note 3)	1,165.3	1,140.9	1,114.0	1,084.7	1,055.4
CURRENT LIABILITIES					
Accounts payable and accrued liabilities	16.5	46.6	47.9	48.5	48.4
Accrued interest	29.7	28.9	28.0	27.2	26.5
Excess earnings	-	-	-	2.3	8.2
Promissory notes	74.3	51.2	64.2	64.3	89.8
Total current liabilities	120.4	126.7	140.1	142.5	172.9
EMPLOYEE FUTURE BENEFITS	38.2	41.2	44.4	47.8	48.7
SHAREHOLDER'S EQUITY					
Retained earnings	219.7	226.7	238.7	253.2	268.5
Total shareholder's equity	219.7	226.7	238.7	253.2	268.5
TOTAL LIABILITIES and SHAREHOLDER'S EQUITY	1,543.6	1,535.6	1,537.2	1,528.0	1,545.5

See accompanying notes

Pro-Forma Regulated Income Statements

	2007	2008	2009	2010	2011
For the years ended December 31					
($ 000,000)					
REVENUE					
Energy sales (Note 4)	442.9	443.2	459.1	466.9	486.3
TOTAL REVENUE	442.9	443.2	459.1	466.9	486.3
EXPENSES					
Operating and administration	94.9	94.6	97.2	98.6	98.3
Fuels (Note 5)	155.5	153.3	153.0	148.7	178.2
RSP Activity	(0.0)	(0.2)	-	3.7	(12.2)
Power purchases	38.4	39.8	46.4	52.8	58.0
Depreciation (Note 6)	39.1	42.9	44.7	43.8	45.2
Interest and guarantee fee (Note 7)	103.1	102.6	100.3	98.5	96.7
Loss on disposals	1.7	1.5	1.5	1.5	1.5
TOTAL EXPENSES	432.6	434.6	443.1	447.6	465.8
NET INCOME	10.3	8.7	16.0	19.3	20.5
RETAINED EARNINGS, BEGINNING OF YEAR	209.4	219.7	226.7	238.7	253.2
DIVIDENDS	-	(1.6)	(4.0)	(4.8)	(5.1)
RETAINED EARNINGS, END OF YEAR	219.7	226.7	238.7	253.2	268.5

See accompanying notes

Pro-Forma Regulated Cash Flow Statements

	2007	2008	2009	2010	2011
For the years ended December 31					
($ 000,000)					
CASH PROVIDED BY (USED IN):					
OPERATIONS:					
Net income from operations	10.3	8.7	16.0	19.3	20.5
Add (deduct) items not involving a cash flow:					
Depreciation	39.1	42.9	44.7	43.8	45.2
Loss on disposal of fixed assets	1.7	1.5	1.5	1.5	1.5
Amortization	5.3	5.4	5.3	4.6	3.7
Employee benefits provision	4.5	4.6	4.8	4.9	2.5
Excess earnings	-	-	-	2.3	5.9
Rate stabilization plan	2.0	4.1	4.5	8.4	(9.2)
ADJUSTED NET INCOME	62.8	67.1	76.8	84.9	70.1
Net change in other non-cash working capital items	(0.9)	17.6	(0.7)	0.7	(2.4)
Employee benefits paid	(1.5)	(1.5)	(1.5)	(1.6)	(1.6)
CASH PROVIDED BY OPERATING ACTIVITIES	60.4	83.2	74.6	84.0	66.0
RATE STABILIZATION PLAN:					
Utility collected (returned)	32.2	12.1	(10.2)	(6.2)	(14.2)
Industrial collected (returned)	(4.3)	0.3	(1.5)	(1.0)	0.1
CASH PROVIDED BY RSP ACTIVITIES	27.9	12.4	(11.6)	(7.3)	(14.1)
FINANCING:					
Long-term debt issued	-	200.0	-	-	-
Long-term debt retired	(23.4)	(203.8)	(5.2)	(6.2)	(4.7)
Dividends paid	-	(1.6)	(4.0)	(4.8)	(5.1)
CASH PROVIDED BY FINANCING ACTIVITIES	(23.4)	(5.5)	(9.1)	(11.0)	(9.9)
INVESTMENTS:					
Increase in sinking funds	(19.3)	(20.5)	(21.8)	(23.1)	(24.5)
Increase in deferred charges	(1.7)	-	-	-	-
Change in fixed assets	(41.1)	(46.5)	(45.1)	(42.7)	(43.0)
CASH USED IN INVESTING ACTIVITIES	(62.2)	(67.1)	(66.9)	(65.8)	(67.5)
NET DECREASE (INCREASE) IN INDEBTEDNESS	2.7	23.1	(13.1)	(0.1)	(25.4)
PROMISSORY NOTES, BEGINNING OF YEAR	77.0	74.3	51.2	64.2	64.3
PROMISSORY NOTES, END OF YEAR	74.3	51.2	64.2	64.3	89.8

See accompanying notes

Explanatory Notes to Financial Statements

1. Basis of Accounting

These unaudited pro-forma financial statements represent the regulated segment of Hydro. Hydro's investments in its subsidiary companies have been eliminated from the Regulated Balance Sheet, and debt has been adjusted to eliminate debt associated with non-regulated activities.

2. Deferred Charges

Deferred charge balances are disclosed for the forecast period in **Table 11**.

Table 11: Deferred Charge Balances
($000,000)

	2007	2008	2009	2010	2011
Foreign exchange losses realized	73.3	71.2	69.0	66.9	64.7
PUB regulatory costs	1.2	0.6	-	-	-
Holyrood asbestos abatement and extraordinary repairs	7.8	5.6	3.5	1.4	0.3
Debt discount and issue expenses	2.8	2.3	2.0	1.6	1.2
Total Deferred Charges	85.1	79.7	74.4	69.9	66.2

3. Long-Term Debt

Long-term debt, promissory notes, and other loans are unsecured. Annually, Hydro pays to the Government of Newfoundland and Labrador a debt guarantee fee of one percent on its total debt in return for an unconditional guarantee from the Province. Total long-term debt details are presented in **Table 12**. Long-term debt and promissory notes are adjusted proportionately to eliminate debt associated with non-regulated activities.

Table 12: Total Long-Term Debt
($000,000)

Series	Rate %	Yr of Issue	Year of Maturity	2007	2008	2009	2010	2011
AA	5.50	1998	2008	200.0	-	-	-	-
V (1)	10.50	1989	2014	125.0	125.0	125.0	125.0	125.0
X (1)	10.25	1992	2017	150.0	150.0	150.0	150.0	150.0
Y (1)	8.40	1996	2026	300.0	300.0	300.0	300.0	300.0
AB (1)	6.65	2001	2031	300.0	300.0	300.0	300.0	300.0
AD (1)	5.70	2003	2033	125.0	125.0	125.0	125.0	125.0
AE	4.30	2006	2016	225.0	225.0	225.0	225.0	225.0
F (2)(3)	5.24	2008	-	-	200.0	200.0	200.0	200.0
Total debentures				1,425.0	1,425.0	1,425.0	1,425.0	1,425.0
Less sinking fund investments				(192.8)	(213.3)	(235.1)	(258.2)	(282.8)
				1,232.2	1,211.7	1,189.9	1,166.8	1,142.2
Other				0.3	0.2	-	-	-
Non-regulated adjustment				(67.2)	(70.9)	(75.9)	(82.1)	(86.8)
Regulated Long-Term Debt				1,165.3	1,140.9	1,114.0	1,084.7	1,055.4

(1) Sinking funds are associated with these issues.
(2) "F" denotes a forecast series.
(3) This issue has indefinite maturity dates.

4. Energy Sales

Detailed disclosures of electricity sales in GWh and in dollars are provided in **Table 4** and **Table 13,** respectively.

Table 13: Energy Sales Revenues by Customer Class
($000,000)

	2007	2008	2009	2010	2011
Island Interconnected:					
Newfoundland Power	329.8	331.7	347.0	356.7	366.2
Island Industrial:					
Firm	44.1	43.1	44.6	44.6	55.6
Nonfirm	0.5	0.8	0.8	0.8	2.2
Rural	39.7	38.2	37.6	38.4	38.1
Total Island	414.1	413.8	430.1	440.4	462.1
Labrador Interconnected:					
CFB Goose Bay	4.5	4.2	3.9	3.7	3.6
Rural	14.5	15.9	16.2	16.4	16.4
Total Labrador	19.1	20.1	20.1	20.1	20.0
Rural Isolated	10.5	10.2	10.1	10.4	10.4
Miscellaneous	2.1	2.1	2.2	2.2	2.2
Annual Excess Earnings	-	-	-	(2.3)	(5.9)
RSP Activity	(2.8)	(3.0)	(3.3)	(3.9)	(2.6)
Total Energy Sales	442.9	443.2	459.1	466.9	486.3

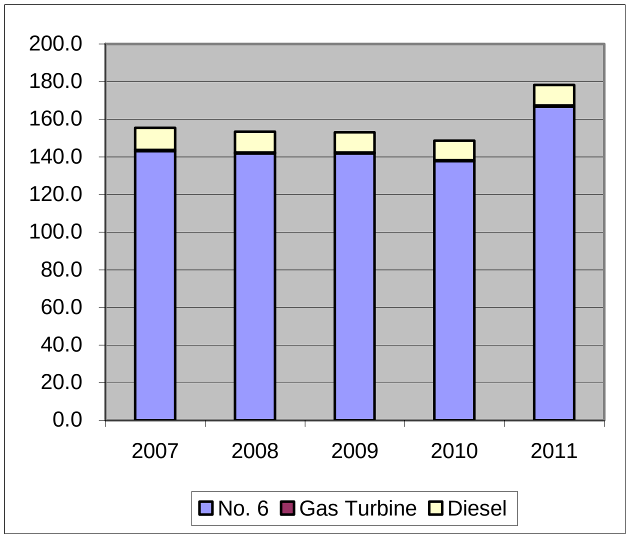
5. Fuel Expenses

Table 14 and **Figure 3** present annual fuel expense details.

Table 14: Fuel Expense Details
($000,000)

	2007	2008	2009	2010	2011
Fuel Expense					
No. 6	143.0	141.8	141.8	137.7	166.7
Gas Turbine	0.7	0.6	0.6	0.6	0.7
Diesel	11.8	10.9	10.6	10.4	10.9
Total Fuel Expense	155.5	153.3	153.0	148.7	178.2

Figure 3: Fuel Expense Details
($000,000)



6. Depreciation Expenses

Detailed disclosure of depreciation expense by asset class is presented in **Table 15**.

Table 15: Depreciation Expense by Asset Class
($000,000)

	2007	2008	2009	2010	2011
Depreciation Expense					
Hydraulic	4.5	4.5	5.1	5.3	5.1
Holyrood	2.9	3.5	4.0	4.3	4.7
Gas Turbines	1.1	1.1	1.2	1.4	1.4
Diesel	2.4	2.4	2.5	2.5	2.4
Transmission Lines	6.3	6.7	7.3	7.5	7.4
Terminal Stations	3.8	3.7	3.5	2.9	3.1
Distribution	4.9	5.1	5.3	5.6	5.7
General Plant and Telecommunications	11.6	12.6	12.3	12.5	13.4
Feasibility Studies	0.6	2.2	2.1	0.5	0.4
Computer Software	0.9	1.0	1.4	1.5	1.5
Total Depreciation Expense	39.1	42.9	44.7	43.8	45.2

7. Interest and Guarantee Fee

Commencing in 2002, realized foreign exchange losses are amortized over a 40-year period. RSP and construction work in progress are financed based on Hydro's Test Year weighted average cost of capital. Financing charges for Hydro's non-regulated debt are calculated at Hydro's Test Year weighted average cost of capital, and that amount is removed from regulated interest expense. Interest and guarantee fee details are provided in **Table 16**, and **Table 17** shows embedded cost of debt calculations.

Table 16: Interest and Guarantee Fee
($000,000)

	2007	2008	2009	2010	2011
Gross Interest					
Long-term debt	101.5	101.2	100.9	100.9	100.9
Promissory notes	3.9	2.7	2.8	3.1	3.9
RSP Interest Expense	-	1.3	1.2	0.9	0.4
	105.3	105.1	105.0	105.0	105.2
Amortization of debt discount and financing expenses	0.6	0.5	0.4	0.4	0.4
Amortization of realized foreign exchange losses	2.2	2.2	2.2	2.2	2.2
TOTAL INTEREST	108.1	107.8	107.5	107.5	107.7
Less					
Allowance for funds used during construction	(1.0)	(0.7)	(0.7)	(0.8)	(0.9)
RSP interest earned	(0.8)	-	-	-	-
Sinking fund and other interest earned	(11.7)	(12.4)	(13.6)	(15.0)	(16.4)
	94.6	94.7	93.1	91.7	90.5
Less financing charges associated with non-regulated debt	(5.2)	(5.2)	(5.5)	(5.8)	(6.2)
Regulated net interest	89.4	89.5	87.6	85.9	84.3
Debt guarantee fee	13.6	13.1	12.7	12.6	12.4
Regulated net interest and guarantee fee	103.1	102.6	100.3	98.5	96.7

Table 17: Embedded Cost of Debt
($000,000)

	2007	2008	2009	2010	2011
Cost of debt:					
Long-term debt	101.5	101.2	100.9	100.9	100.9
PromissoryNotes	3.9	2.7	2.8	3.1	3.9
Amortization of debt discount and fiduciary fees	0.6	0.5	0.4	0.4	0.4
Amortization of realized foreign exchange lsoses	2.2	2.2	2.2	2.2	2.2
Guarantee fee	13.6	13.1	12.7	12.6	12.4
Less sinking fund interest	(11.2)	(12.4)	(13.6)	(15.0)	(16.4)
Less interest allocations	(5.2)	(5.2)	(5.5)	(5.8)	(6.2)
Cost of debt	105.4	102.1	99.8	98.4	97.1
Average net debt:					
Total long-term debt	1,425.3	1,425.2	1,425.0	1,425.0	1,425.0
Promissory Notes	78.5	54.3	68.6	69.2	97.2
Less sinking funds	(192.8)	(213.3)	(235.1)	(258.2)	(282.8)
Less unamortized issue expenses	(2.8)	(2.3)	(2.0)	(1.6)	(1.2)
Less allocated debt	(69.2)	(70.2)	(74.4)	(78.9)	(83.9)
Net debt	1,239.2	1,193.6	1,182.2	1,155.5	1,154.3
Average net debt	1,261.4	1,216.4	1,187.9	1,168.8	1,154.9
Average embedded cost of debt	8.4%	8.4%	8.4%	8.4%	8.4%

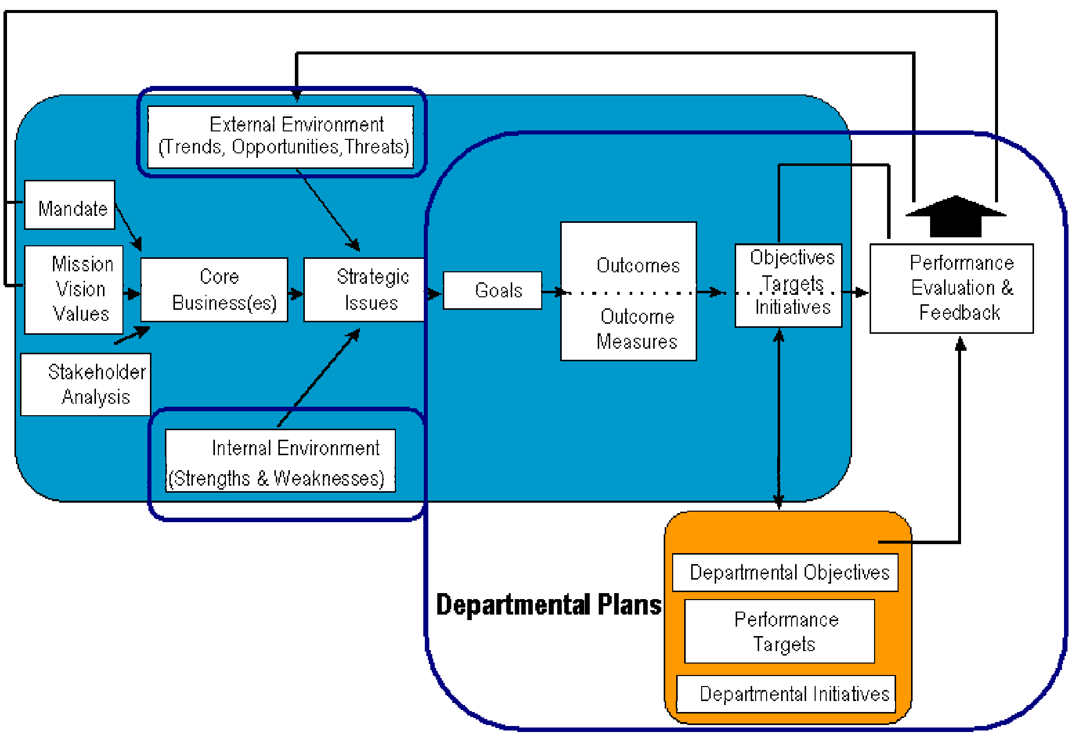
Appendix A – Strategic Planning Overview

BACKGROUND

In the fall of 2005, Hydro's senior leadership team developed an approach to strategic planning and performance management at the corporation based on the following guiding principles:

- Proven Planning Methodology: Use a proven, best practice strategic planning methodology and in-house expertise;
- Employee Engagement: Include many more people at all levels in the organization in the planning process and ensure there is adequate regional representation;
- Managers'/Supervisors' role: Have managers and supervisors play a key role in getting employee input, developing the plan, and communicating direction;
- Linkage: Ensure a clear line of sight from corporate to departmental objectives and ultimately to personal objectives;
- Focus on Execution: A good plan well executed better that an excellent plan that is not,
- Long-term Outlook: Base the strategic plan on a 10-year outlook, with 3-5 year goals supported by annual objectives.

PLANNING METHODOLOGY



2005/2006 PROCESS HIGHLIGHTS

- Employee Input: In October 2005, managers facilitated sessions with employees across the organization to get their views on Hydro's strengths and weaknesses and the opportunities and threats the corporation faces. The summary of this input was provided to the senior leadership team.
- Developing the Corporate Plan
  - Corporate Goals: The senior leadership team drafted eight goals addressing Hydro's four lines of business: Regulated Business; Churchill Falls Labrador Corporation; Lower Churchill Project; and

        - New Business Development. These goals were fully aligned with the mandate/direction outlined by the shareholder and Board of Directors.
    - Corporate Outcomes/Measures: Small groups from the senior leadership and management groups identified possible outcomes and measures that would be used to assess progress on meeting each of the goals.
    - Corporate Objectives: Specific corporate objectives were drafted with performance targets established for 2006, 2007 and 2008.
- Communicating the Plan
    - Managers' Workshop: In late February, the senior leadership team and managers from across the corporation met to discuss and finalize the content of the corporate plan.
    - Meeting with IBEW: The content of the corporate plan and the planned approach for cascading the corporate direction through the organization was reviewed with members of the executive board of the IBEW.
    - Field Supervisor Information Sessions: During May and June, members of the senior leadership team met with frontline supervisors, IBEW executive board members and other leaders in our field locations to present an overview of the 2006 corporate plan.
    - Employee Checkpoint Sessions: In order to communicate the corporate direction to all employees, employee checkpoint sessions were held throughout the province during June. These sessions presented an overview of the corporation's goals, objectives, and targets and also highlighted progress for the first part of the year.
- Aligning the Organization
    - Business Unit Planning Process: Managers throughout the corporation developed 2006 work plans for their departments, regions and plants. Following the model of the corporate level planning process, managers engaged members of their teams to develop the plans and when the plans were completed held meetings/workshops to discuss the content.
    - Testing Alignment: All business unit plans were reviewed by the responsible business unit vice-president and subsequently with the CEO.
- Measuring Progress
    - Tracking Progress: In March 2006 when the corporate plan was completed, the senior leadership team began holding monthly performance review meetings. These meeting focus on assessing year to date performance for corporate targets and also review the year-end outlook for each of these targets. If performance is off-target, action plans for recovery are outlined and approved for implementation.
    - Reports to the Board of Directors: The review of progress against corporate plan targets is a standing agenda item at meetings of the Board of Directors.
    - Communicating Progress: The monthly corporate plan performance report is available to all employees through Hydro's corporate intranet. In addition, posters summarizing progress on key measures related to safety, system reliability and financial performance are posted throughout the corporation.

OPPORTUNITIES FOR IMPROVEMENT

- Integrated Planning: For effective strategy execution, planning and budgeting processes must be fully integrated. The direction and priorities outlined in the corporate planning process should drive the financial plans outlined during the annual operating and capital budgeting cycles as well as multi-year financial planning. 2007 budgets have been tested against the corporate plan for high-level alignment however, the timing of corporate planning cycle is being improved to ensure that input is available drive the development of budgets and financial plans.
- Maintenance Planning Priority: A key initiative identified in the 2006 planning process is the development of a maintenance planning philosophy. As an asset intensive organization, Hydro recognizes the requirement to have comprehensive plans to maintain assets over their lifecycle as well as planning for their replacement. A comprehensive maintenance plan will drive a significant portion of Hydro's operating and capital budgets in the regulated business.

- Increasing Understanding: Hydro recognizes that gaps between planned and actual performance result largely from a lack of awareness or understanding of the strategy. While significant progress was made in 2006, our approach to planning for future years will include additional opportunities for employee engagement.
- Performance Monitoring: For 2007 and beyond, performance management at the business unit level requires increased attention. Building on the corporate approach, measures need to be selected and approaches for tracking and improving performance need to be enhanced for departments, regions and plants.

Appendix B – Corporate Goals

Attached are the four corporate goals that relate to the regulated business. This represents the 2006 plan, with targets to 2008. We are currently in the middle of the annual update of this plan.

Goal: To be a safety leader.

Nobody gets hurt. Our employees and their families understand that our workplace is safe; our employees go home in good health every day. We intend to provide the safest work environment compared with the best performers in any industry and we will make sure our customers and the public understand, and are protected against, the hazards of our facilities.

Corporate Objectives

- Reduce the number of disabling/medical aid incidents for the Hydro Group to 0 in five years (0 in 5)
- Reduce the number of disabling incidents for the Hydro Group to 0 in three years (0 in 3)

2006 Target	2007 Target	2008 Target
Increase the number of hazards / "near misses" reported by 30%	Assess 2006 performance and set target.	Assess 2007 performance and set target.
Reduce the number of disabling/ medical aid injuries by 25%	Reduce the number of disabling/ medical aid injuries by 35%	Reduce the number of disabling/ medical aid injuries by 38%
Reduce the number of disabling injuries by 33%	Reduce the number of disabling injuries by 50%	O in 3: No disabling injuries.

2006 Strategic Initiatives

- Develop a safe observation reporting process in 2006 with full implementation for January 2007 (available for test in August 2006).
- Develop a corporate safety strategy to achieve "0 in 5" and "0 in 3".
- Develop an Emergency Response Plan.

Goal: To be an environmental leader.

As a company and a member of the community we have a belief and a responsibility to protect the environment we live and work in. We will strengthen our commitment to protecting the environment and will focus on reducing emissions from our power generation activities. Our Environmental Management System and ISO 14001 certification are key components of this commitment.

Corporate Objectives

- Displace 200,000 barrels of oil by 2009 by increasing use of renewable energy sources.
- Decrease SO_2 emissions in Holyrood.
- Increase the number of leadership team approved Environmental Management System (EMS) targets and objectives accomplished.

2006 Target	2007 Target	2008 Target
Island Wind (25MW): Receipt of final proposals, selection of proponent and execution of power purchase agreement.	Island Wind (25MW): Final design complete and construction begins.	Island Wind (25MW): Construction completed, project commissioned (end of 2008).
Decrease SO_2 emissions in Holyrood by 30% in 2006 (1.68 tonnes of SO_2 per GWH)	Assess 2006 performance and set target.	Assess 2007 performance and set target.
Increase the number of leadership team approved Environmental Management System (EMS) targets and objectives accomplished within the Hydro Group from 75% in 2005 to 90% in 2006	Increase the number of leadership team approved Environmental Management System (EMS) targets and objectives accomplished within the Hydro Group to 95%.	Increase the number of leadership team approved Environmental Management System (EMS) targets and objectives accomplished within the Hydro Group to 100%.

2006 Strategic Initiatives

- In 2006, develop a conservation strategy that drives energy use reduction by all consumers of electricity. The strategy should include identifying a baseline for energy consumption and targets for reduction in 2007 and future years.

Goal: Through operational excellence, to provide exceptional value to all consumers of our energy.

Our customers - industrial and residential, and indeed all consumers of electricity in the province will receive exceptional value. This value relates to rates, service, public safety, reliability, and power quality.

Corporate Objectives

- Improve reliability of power supply
- Achieve controllable costs targets
- Increase availability of generating plant

2006 Target	2007 Target	2008 Target
Generation		
Improve winter availability of generating plant to: January – 89.5%; February - 98%; March and December - 97%.	Improve winter availability of generating plant to: January and February - 99%; March and December - 98%.	Improve winter availability of generating plant to: January and February - 99%; March and December - 98%.
Transmission		
Improve delivery point SAIFI (forced only) from five-year average of 1.46 to .98.	To be established during the 2007 planning process	To be established during the 2007 planning process
Meet or beat delivery point SAIDI of 15.0 for Newfoundland Power	Meet or beat delivery point SAIDI of 15.0 for Newfoundland Power	Meet or beat delivery point SAIDI of 15.0 for Newfoundland Power.
Financial		
Meet or beat controllable costs at $93.1M.	Maintain controllable costs constant in real terms and adjusted for infrequent items.	Maintain controllable costs constant in real terms and adjusted for infrequent items.
Hydro's total capital program completed within +/-2% of approved budget.	Hydro's total capital program completed within +/-2% of approved budget.	Hydro's total capital program completed within +/-2% of approved budget.

2006 Strategic Initiatives

- Document corporate philosophy re asset maintenance.
- Review annual spill versus avoidable spill methodology and propose an appropriate system to measure performance.
- Develop a plan to establish clear targets for levelized unit energy costs over a targeted time frame.
- Develop a long-term plan to optimize our mix of assets/potential developments over time.

Goal: To ensure a highly skilled and motivated team of employees who are strongly committed to Hydro's success and future direction. We need employees who feel valued and are in engaged in Hydro's new direction. This requires strong leadership at all levels, employees who are skilled and performance focused, and a collaborative relationship between union executive and Hydro management.		
Corporate Objectives ▪ By 2009, improve all elements of employee engagement to a level where Hydro would qualify for recognition as one of Canada's best employers in reference to an acceptable external benchmark.		
2006 Target	2007 Target	2008 Target
Identify current state/desired state and gap closure strategy to be recognized as a best employer.	Implement gap closure strategy.	Implement gap closure strategy.
Complete three Leadership Series workshops	Complete three Leadership Series workshops	Complete three Leadership Series workshops
2006 Strategic Initiatives ▪ Complete a succession plan.		

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