Q. Please provide copies of the last five annual reports for Hydro.

A. Attached are copies of Hydro's annual reports for the years 2001 to 2005.

2001

Annual Report

Newfoundland and Labrador Hydro

HYDRO
THE POWER OF COMMITMENT

Mission

Newfoundland and Labrador 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.

Our skilled and committed employees will use innovative methods and technologies, and will maintain high standards of safety and health, and environmental responsibility.

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HYDRO
THE POWER OF COMMITMENT

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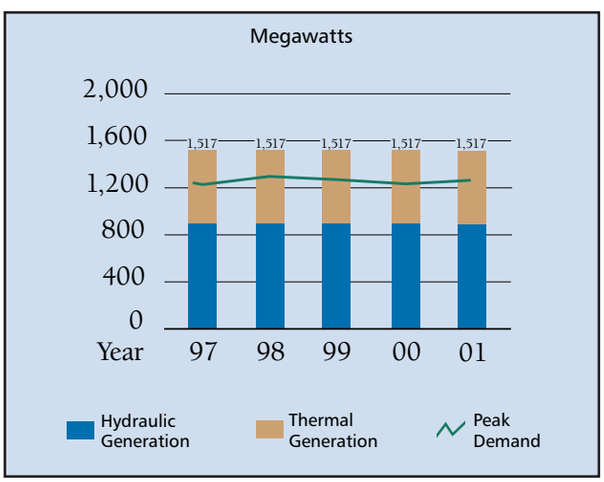
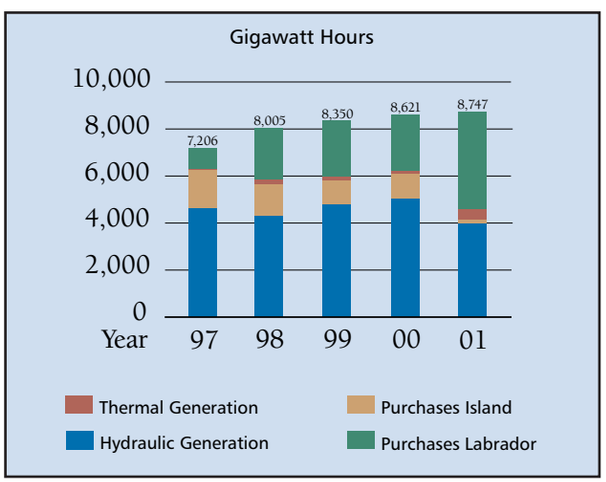
Facsimile: (709) 737-1231
Website: www.nlh.nf.ca
E-mail: hydro@nlh.nf.ca

Highlights

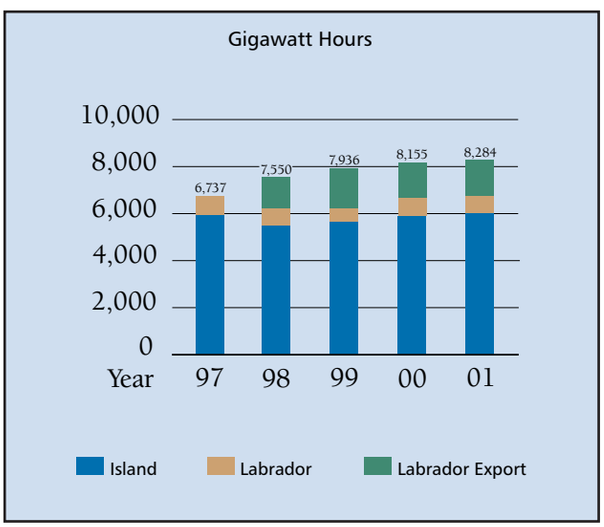
Island Interconnected Systems Gross Generated Capacity and Demand



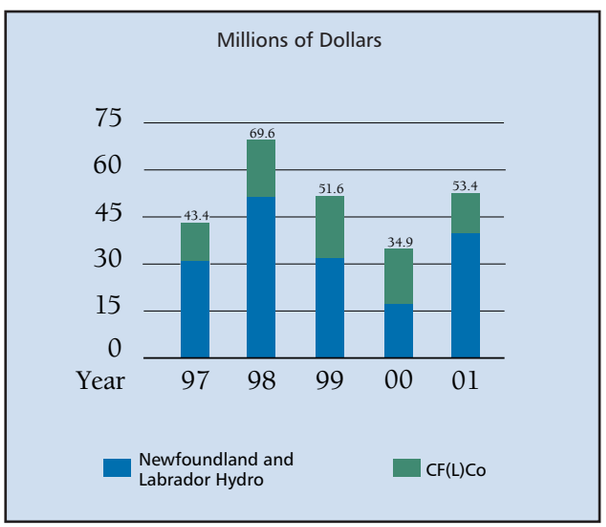
Interconnected Systems Gross Energy Generated and Purchased



Interconnected Systems Energy Sales



Consolidated Net Income



Year in Review

Newfoundland and Labrador Hydro (Hydro) is a crown corporation, owned by the Province of Newfoundland and Labrador (province). Hydro generates, transmits and distributes electrical power and energy to utility, residential and industrial customers throughout the province.

Hydro is the parent company of the Hydro Group of Companies (Hydro Group) comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation Limited (LCDC), Gull Island Power Company Limited (GIPCo), and Twin Falls Power Corporation Limited (TWINCo). The Hydro Group's installed generating capacity is the fourth largest of all utility companies in Canada. Our power generating assets include eight hydraulic plants, one oil-fired plant, four gas turbines, 29 diesel plants and the Churchill Falls hydraulic plant, which is the largest underground powerhouse in the world with a rated capacity of 5,428 megawatts (MW) of power.

Each year, the Hydro Group generates over 80 per cent of the energy consumed within the province. With a workforce of about 1,060 employees, the corporation directly serves several large industrial customers in the province and over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Hydro also sells energy to Newfoundland Power, an investor-owned utility that distributes electrical power to the balance of the province's population.

Chairman and President's Report

We are pleased to report, on behalf of the Board of Directors, that 2001 was another successful year for the Hydro Group of Companies. We met our financial targets, successfully managed operating costs, improved system reliability, and operated in an environmentally responsible and prudent manner.

Overall, net income for the Hydro Group was $53.4 million on revenues of $397.1 million, a net income increase of $18.5 million over 2000. Earnings from Newfoundland and Labrador Hydro (Hydro) were the largest component of the Hydro Group's net income at $40.4 million compared to $17.4 million in 2000. This increase of $23.0 million is primarily the result of a renewal of the agreement on the sale of 130 megawatts (MW) of recall power and energy to Hydro-Québec. The net income from CF(L)Co was $13.0 million, compared to $17.5 million in 2000. This decrease of $4.5 million is due to lower energy sales and increased operating costs.

Energy sales within the province vary from year to year, depending on the level of demand from residential customers and on the level of activity among industrial users. Hydro's sales, on the Labrador and Island Interconnected Systems combined, grew by one per cent in 2001. This 1.0 per cent increase is the result of

Reginald Sheppard,
Line Worker, Harbour Breton

a 2.1 per cent increase in demand on the Island System (to 6,017 gigawatt hours (GWh)) and a 7.0 per cent decrease in sales on the Labrador System (to 709 GWh). Higher sales to Newfoundland Power offset slightly lower sales to Hydro's industrial customers. The decrease on the Labrador Interconnected System was primarily due to reduced sales to an industrial customer.

The Guaranteed Winter Availability Contract between CF(L)Co and Hydro-Québec increased revenue by $2.9 million despite a decline in CF(L)Co export sales. CF(L)Co produced 32,910 GWh in 2001, 6.4 per cent less than 2000. Lower reservoir storage levels and lower demand from Hydro-Québec caused decreased export sales. CF(L)Co exported 28,159 GWh, 7.0 per cent below 2000. Sales to Hydro decreased to 2,381 GWh, and deliveries for TWINCo were lower at 1,821 GWh.

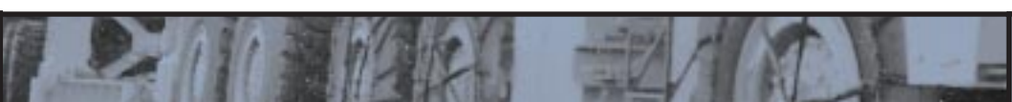
A renewal of the three-year agreement for the energy associated with the 130 MW sale by Hydro of Churchill Falls recall power to Hydro-Québec became effective March 9, 2001. Gross revenues under the new agreement are expected to be in the vicinity of $98 million, resulting in a profit to Hydro of approximately $86 million.

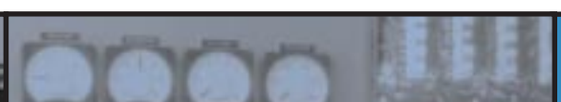
Encouraging financial results have a positive impact on our corporate performance. They support our mission of providing least cost, reliable electrical power and energy in a safe and environmentally sound manner.

Least Cost Electrical Power and Energy

Providing least cost electrical power and energy means keeping electrical rates and all costs as low as possible, while providing a reliable, safe, and environmentally acceptable energy supply.

During 2001, we focused significant resources on the task of filing a general rate application with the Board of Commissioners of Public Utilities (PUB). This year, for the first time in 10 years, Hydro requested a general rate increase from the PUB. Our proposal for an increase of 6.6 per cent to Newfoundland Power would result in an approximate 3.6 per cent increase in retail rates, and an 8.5 per cent increase in industrial rates if approved by the PUB. The PUB convened a hearing on our proposal on September 24, 2001.





L Background:
Brian Pierce, Line Worker,
Harbour Breton

L Foreground:
Jim Crewe, Line Worker
Apprentice, Bay d'Espoir

R Bucket:
Allan Crewe, Line Worker,
Harbour Breton

R Foreground:
Joe Walsh, Lines Supervisor,
Bay d'Espoir

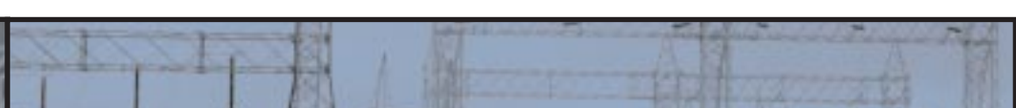
Preparation and presentation of our application to the PUB was a lengthy, complex and challenging process, requiring significant effort on the part of those involved. The application generated over 20,000 pages of evidence and lasted for 68 days. Hearings concluded early in 2002 and we are currently awaiting a decision from the PUB.

One of the major reasons for the rate hearing was, and continues to be, the large difference between the real cost of fuel required to supply the Holyrood Thermal Generation Station (HTGS), and the cost included in our current rate formula approved by the PUB in 1991. The HTGS provides up to one quarter of the Island's electricity requirements by using Bunker C fuel (grade no. 6) to produce electricity. The consumption of fuel at the plant is dependent on production and demand and may vary from one and a half million to three and a half million barrels a year.

Current electricity rates include a price component for fuel of $12.50 a barrel, set by the PUB in 1991 when Hydro filed its general rate application. Hydro, in its general rate application filed on May 30, 2001, proposed that the price of fuel to be included in its rates be set at $20 per barrel. The proposal will permit the rates charged to electricity consumers to more properly reflect the current cost of fuel.

If the price of fuel is re-based at $20 per barrel in Hydro's rates, it will have a positive impact on the Rate Stabilization Plan (RSP), a plan intended to smooth out fluctuations in customers' bills as a result of variations in fuel prices, load and hydraulic production. To reduce the immediate impact on customers, we requested an increase in the current RSP cap for Newfoundland Power from $50 million to $85 million. This would allow the difference between the actual cost of fuel and the $20 per barrel included in Hydro's proposed rates to accumulate in the RSP and continue to be automatically recovered from customers over a three-year period.

The PUB was also requested to approve more uniform rates for customers on the Labrador Interconnected System. We proposed restructuring the current 24 rate classes in Labrador City, Happy Valley/Goose Bay and Wabush into six rate classes. This proposal reflects the principles used in rate-setting on the Island Interconnected System and supports the proposition that customers receiving essentially the



L Background: Gerard Piercy, Civil Engineer, Granite Canal

L Foreground: Bob Barnes, Project Manager, Granite Canal

R: Dave Vokey, Environmental Coordinator, Granite Canal

same service from an interconnected system should pay similar rates. Other issues dealt with in the application included rural subsidies, the cost of service, and the setting of rates based on a rate of return on regulated rate base. Hydro's 2002 capital budget was also submitted for approval.

Granite Canal Hydroelectric Development

Prior to the end of 2001, construction began on the Granite Canal Hydroelectric Development, a 40 MW project situated within the existing Bay d'Espoir development. Work on the project has progressed on schedule and within budget.

This year's construction phase followed design and specification preparation as well as tendering and contract execution. By the end of 2001, contractors had completed the 250-person construction camp; finished excavating the powerhouse, penstock, intake and power canal; poured over 4,000 m^3 of concrete at the powerhouse and intake; constructed the warehouse; completed over 75 per cent of their detailed design work; upgraded 86 km of road to the site; and cleared and started surveying the transmission line right-of-way. The use of new technologies throughout the transmission line design process has resulted in time savings.

Throughout the development of this project, specific emphasis has been placed on associated environmental issues. The public has been consulted and Hydro has provided a comprehensive review of its extensive environmental monitoring and mitigation plans. Sensitivity to environmental concerns includes items such as consideration of five years of data on caribou migration in the area of the project. Environmental principles and policies have been set and internal procedures are in place to ensure environmental policies are followed.

The Granite Canal plant is scheduled to begin producing electrical energy by mid-2003. It will be remotely controlled from our Energy Control Centre in St. John's and will assist us with supplying the Island's power and energy requirements in the future.

System Reliability

Hydro is dedicated to providing quality power within a reliable system. In 2001, we improved service to customers by decreasing the number and duration of power outages; we achieved operating capacity records at Holyrood in response to additional demands; and we undertook capital works projects to improve the reliability of our transmission lines, to enhance telecommunications infrastructure, and to conduct significant maintenance work at Churchill Falls.

Inter-Utility Cooperation

In 2001, we moved into the second year of a joint initiative to improve the performance on the Island Interconnected System. The Inter-Utility System Reliability Committee, comprised of senior representatives from Hydro and Newfoundland Power, sets objectives to continually improve service to the customers of both utilities.

This year, our efforts to achieve performance targets in the operation of the transmission network both on the Island and in Labrador were successful. We improved our record for outages and outage durations to our high

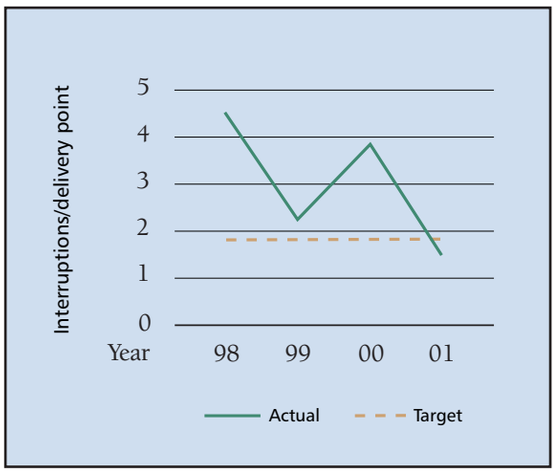
Glenn Hicks, Network Services Engineer, Chapel Arm Microwave Site

voltage delivery points to Newfoundland Power, to industrial customers and to our distribution systems. Our actual outage frequency and duration results were well below established targets for 2001. The number of outages was 20.1 per cent better than our target, and the outage time was 36.1 per cent better.

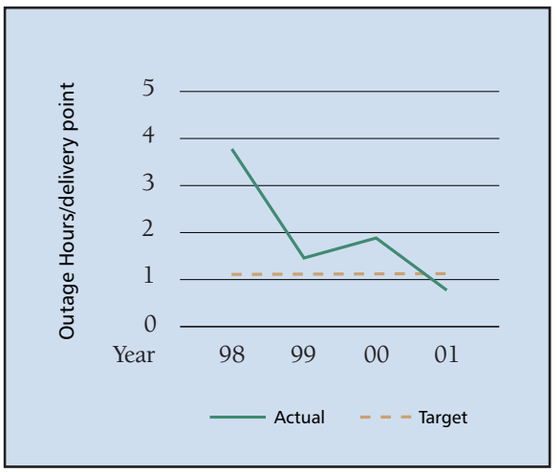
Our ongoing efforts to improve system reliability, coupled with favourable weather conditions in 2001, enabled us to exceed our expectations. Moreover, we have undertaken specific actions such as installing lightning arrestors on critical 230 kilovolts (kV) transmission lines; maintaining a lightning tracking system; replacing insulators; and upgrading transmission line ice-loading capability while continuing to raise the profile of reliability throughout the corporation.

Hydro will continue efforts to improve reliability performance in 2002.

Outage Frequency



Outage Duration



Chapel Arm Microwave Tower

Gerard Dunphy, Senior Project Leader, Engineering, Kilbride Microwave Site

Peak Production Records

Reservoir levels deteriorated significantly in 2001 as Hydro experienced its seventh-lowest year of inflows in a 51-year period. This resulted in a significant increase in thermal production from HTGS to 2,219 GWh, the second highest on record. Production from Hydro's hydraulic resources decreased by 21 per cent to 64 per cent of the corporation's total production.

The high production at HTGS resulted in production-related records throughout the year. During December, the plant established a record high output of 504 MW and a one-day production record of 11.8 GWh. In addition, the plant achieved a record annual efficiency factor of 633 kWh/barrel of fuel. High utilization and on-line Performance Monitoring Programs on each unit contributed to the achievement of these results. From November 16, 2001, the three generating units at HTGS were operating at full capacity.

Avalon Transmission Line Upgrade

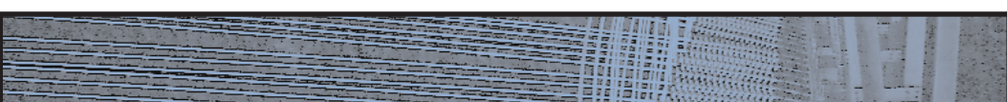
Construction continued in 2001 on a multi-year capital program to strengthen transmission lines on the Avalon Peninsula. By the end of the year, the third phase of the upgrade program between Come-by-Chance and Chapel Arm was completed.

The upgrade, involving 44 km of transmission line, was completed on schedule and on budget. It will improve the reliability of our 230 kV transmission lines under wind and ice-loading conditions. It will also result in an increase in load-carrying capability, which will provide an opportunity for more flexible and efficient use of our generating resources on the Avalon Peninsula.

Work is continuing on the final phase, which is to upgrade two transmission lines between Holyrood and St. John's.

East Coast Microwave Project

The East Coast Microwave Project is a new digital microwave radio system that provides communications to the majority of the power transmission terminal stations on the Avalon Peninsula. This state-of-the-art telecommunications infrastructure was constructed to replace powerline carrier systems that were at the end of their 30-year service life and to improve our ability to restore power during system disturbances. The project involved the construction of nine microwave towers and the installation of associated communications equipment.



L: Gary Feltham, Planner for Maintenance Planning, Churchill Falls

C: Trudy Sooley, Office Clerk, Bay d'Espoir

R: Dale Wells, Millright, Churchill Falls

West Tailrace Tunnel Maintenance

In 2000, the first inspection of the mile-long West Tailrace Tunnel at Churchill Falls was completed. The tunnel, in generally excellent shape after more than 28 years of service, required maintenance on a very short section. This was successfully completed in 2001 at a cost of $3.5 million without any disruption in service.

Environment

We continue to maintain our proactive position on environmental responsibility and stewardship. This year, among many other environmental initiatives, we produced a comprehensive report on our environmental activities and performance. Efforts continued to develop and maintain environmental management systems that meet international standards, and we continued to enhance public awareness and foster open communication with our stakeholders.

Environmental Performance Report

In 2001, we published our first annual Environmental Performance Report. Although protection of the environment has long been one of our corporate priorities, the report provided us with a means to inform stakeholders of the comprehensive set of principles which guide our environmental activities and evaluate our performance.

ISO 14001 Registration

We are committed to continuing our work in meeting worldwide quality environmental standards. In 1997, we adopted the Environmental Management System (EMS) standard established by International Organization for Standardization (ISO). This standard, also adopted by the Canadian Electricity Association, sets a framework for continually improving environmental performance.

To meet the ISO 14001 standard, the Hydro Group has been divided into management areas, each with its own environmental management team comprised of local senior managers. Each area sets objectives and targets, and plans and implements programs to achieve them. Independent auditors evaluate the management system's effectiveness in controlling those aspects of its activities that may have a significant impact on the environment. Upon successful review, management areas qualify for ISO 14001 certification. The EMS, however, must continually improve for certification to be maintained.

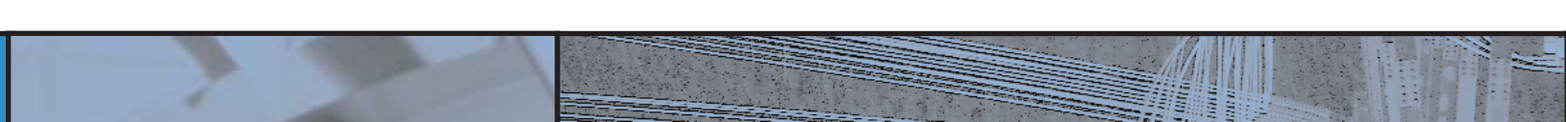
We began our goal of achieving ISO 14001 performance measurements throughout the entire corporation with our thermal generating station at Holyrood (1999), followed by our hydro generating stations on the Island and in Labrador, which received ISO 14001 certification during 2000. In 2001, we achieved certification for our corporate management and services management areas.

The Transmission and Rural Operations (TRO) Division has begun the process of implementing an EMS. We hope to achieve full implementation in each of the three TRO regions by the end of 2002, and receive ISO 14001 certification in 2003. This will include the transmission network and rural operations including diesel generators and associated distribution network.

The EMS for the Services departments will be expanded to include departments which provide services to TRO and other corporate activities.

Stack Emissions Testing

Stack emissions testing, conducted every two years, was performed on the three generating units at Holyrood



L: Claude Quinton, Transmission Lines Specialist, Bishop Falls

C: Dion Farrell, Lineworker, Bay d'Espoir

R: Ina Miller, Air Services Clerk, Churchill Falls

during 2001. These tests monitor particulates, particulate particle size, metals, sulphates, sulphur dioxide (SO_2), nitrogen oxides (NO_x), carbon monoxide (CO), and carbon dioxide (CO_2) in the exhaust stacks.

The test results are reported to the provincial Department of Environment to satisfy an existing agreement. Test results also provide on-site measurement data to be used for site evaluation, annual reporting and exhaust-gas modeling. These results provide data on our initiatives to improve overall unit performance and efficiency.

Community Liaison Committee

In an effort to enhance public awareness and foster open communication with stakeholders, the management of the Holyrood plant continued meetings with its Community Liaison Committee. The committee is comprised of representatives from the provincial Department of Environment, the Town of Conception Bay South, the Town of Holyrood, the Regional Health and Community Services Board, and Hydro management.

The meetings, held bi-monthly, present a forum to review plant performance as it relates to the general public. Discussions address general inquiries and impending operational issues. At each meeting, we present a status report of Holyrood's EMS and Environmental Management Programs. The report covers topics such as air monitoring, generating unit efficiency, asbestos abatement, controlled substance spill, waste material recycling, auxiliary power usage, general service cooling water usage, waste disposal of contaminated materials and oil system leak detection surveillance.

The work of the Community Liaison Committee is conducted in the spirit of open community consultation. We consider it to be one of the successes that has and will continue to guide us in our efforts to be more aware of the concerns of local residents.

Open House

We invited the general public to attend an open house at Holyrood during Environment Week. The theme for Environment Week 2001 was "Acting Today for Tomorrow".

Throughout the week, group tours were scheduled and an official open house was held. Displays focused on environmental activities such as the plant's EMS and on facilities like the ambient air monitoring network, wastewater treatment plant and controlled waste landfill. Guests were invited to view a slide presentation and take a guided tour of the facility.

Employees

We recognize the contribution of each one of our employees towards the overall success of the corporation. We remain committed to providing them with a safe work environment in which they can feel respected and valued.

Safety and Health Program

Safety continues to be the corporation's first priority. Early this year, we introduced a revised Safety and Health Program; and by the end of the year, most employees had received a comprehensive introduction to the program. The objective of the revised program is to provide employees and our contractors with more comprehensive direction and guidance for safety and health in the workplace.

We are committed to protecting our employees from personal injury and occupational illness by providing and maintaining safe and healthy workplaces. Both Hydro

L: Jerry Thompson, Drafter, Bishop Falls

C: John Coffey, Heavy Equipment Operator, Churchill Falls

R: Harold Lee, General Maintenance, Bay d'Espoir



and CF(L)Co have made significant reductions in the frequency and severity of accidents since last year.

Our goal is to achieve the best possible safety record in our industry.

Contributions

The Hydro Group and our employees contribute annually to numerous charities and projects. In 2001, corporate donations were made to hospitals, youth groups and the arts, among others. Employees and their social clubs held special fundraisers to assist food banks and raise funds for a variety of worthy causes.

Both the Hydro Group and our employees provided assistance following the September 11th terrorist attacks on the United States. We provided a special corporate donation to the Canadian Red Cross; social club members collected funds from employees to provide additional financial support; and employees donated comfort kits and took it upon themselves to organize a breakfast at our offices for stranded airline passengers diverted to St. John's following the attacks.

Customer Service

We are committed to listening to customers. In 2001, we continued to survey customers to measure their satisfaction with the service provided. Overall, 96 per cent of our residential customers were satisfied with the level of service provided by our employees. Furthermore, our Customer Service Index (CSI), a weighted average of satisfaction scores for each of 14 issues, was 7.9 out of 10. The analysis of information collected in these surveys enables us to identify opportunities and implement practices to continuously improve our record of customer service.

In 2001, we redesigned our customer newsletter. Customer News continues to readily address issues our customers have identified as important. We have also implemented three new initiatives to improve workflow, establish consistency, and improve efficiency in the way employees respond to customer requests and inquiries. Our "Contribution in Aid of Construction" (CIAC) on-line system is part of a new process for handling new service requests; our "Damage Claim" on-line system makes it easier for us to handle customer damage claims; and our "Customer Assistance" database enhances our ability to process general customer inquiries.

In 2002, two new payment options will be introduced for customers – an equal payment plan and a pre-authorized payment option – in response to customer interest. We will continue to focus on customer concerns and will respond to identified customer needs to ensure continuous improvement in the service provided.

Meter Shop

Hydro's meter shop in St. John's received formal accreditation from Measurement Canada on February 21, 2001. An accredited meter shop permits us to seal our own customer meters and, as well, allows us to provide service to others. Accreditation followed a Measurement Canada review and audit of the ISO 9000-compliant Quality Assurance Program for customer metering. This program covered the revenue metering process from start to finish and involved all employees who are involved in providing meters to our customers.

We are proud that Hydro is the only organization in Newfoundland and Labrador to have an accredited Meter Shop. This reflects our employees' commitment and brings a higher level of quality assurance to our customer metering process.


L: Edward Mullaly, Mechanical Maintenance Supervisor, Churchill Falls

C: Madonna Pelley, Inventory Control Supervisor, Bishop Falls

R: Philip Chislett, Mobile Equipment Operator, Churchill Falls

Future

The Government of Newfoundland and Labrador previously announced that it would conduct an Energy Policy Review to establish the future direction for the electricity industry within the province. The review includes an examination of existing legislation and regulation, the existing electricity industry structure, pricing, electricity supply, and the use of electricity as a tool for economic development. A position paper is expected to be released in the Spring of 2002.

Internally, meetings continued in 2001 to involve employees at all levels in an ongoing strategic planning process to ensure our future success. In 2002, the emphasis will continue on the establishment of key performance indicators which demonstrate Hydro's ability to meet its commitment of reliable, least-cost power in the future. This process will have a significant impact on how the organization will evolve to meet future needs.

As we move to the future, providing cost-effective, reliable service in a safe and environmentally friendly manner continues to be our priority. In 2002, we are looking forward to receiving a decision from the PUB on our general rate application; making progress on the Granite Canal Hydroelectric Development; improving system performance; finalizing a multi-year capital program to strengthen transmission lines on the Avalon Peninsula; completing ISO 14001 registrations; and making additional progress with safety and health in the workplace.

We would like to note the retirement of Executive Vice-President (Production) and President of CF(L)Co, David Collett, following a 35-year career with the Hydro Group. He has made an outstanding contribution to the organization, and we wish him well. We would also like to thank members of the Hydro Board of Directors for their contribution and support during the last year.

On behalf of our Board, we would like to thank our employees for their continued commitment this year. It is through them that we achieve recognition as a cost-effective and quality supplier of energy services.

William E. Wells
President and Chief Executive Officer

Dean T. MacDonald
Chairman of the Board

Financial Report

Financial Review and Analysis

This review and analysis focuses on the consolidated operating results and financial position of the Hydro Group of Companies, except where commentary is identified as relating to Hydro only.

2001 Financial Performance Compared To Previous Year

millions of dollars	**2001**	2000
Total revenue	**397.1**	379.7
Total expenses	**343.7**	344.8
Net income	**53.4**	34.9
Dividends	**53.3**	69.9
Retained earnings	**528.6**	528.5

Results of Operations

Net Income

Net income for 2001 amounted to $53.4 million compared with $34.9 million for 2000. The increase of $18.5 million was mainly due to an increase in the sale of recall energy to Hydro-Québec combined with a small decrease in operations and administration expenses.

Revenue

Total revenue for 2001 was $397.1 million, an increase of $17.4 million over 2000. Energy sales for 2001 were $374.8 million, an increase of 5.0% or $17.8 million over 2000, primarily as a result of higher sales of recall energy to Hydro Québec and higher retail sales to Newfoundland Power. This was partially offset by lower rural sales. Recovery of costs included in the Rate Stabilization Plan decreased from $13.9 million in 2000 to $11.2 million in 2001. The guaranteed winter availability contract between CF(L)Co and Hydro-Québec, also increased revenue by $2.9 million. Other revenue decreased by $0.6 million.

Expenses

Total expenses for 2001 amounted to $343.7 million, a decrease of 0.3% or $1.1 million from 2000. The total cost of fuels was $50.2 million in 2001, an increase of $7.7 million over 2000, primarily due to the changes in fuel prices, energy sales and hydraulic generation. Power purchases totaled $15.6 million in 2001, a decrease of $0.2 million from 2000. Operations and administration expenses were $119.1 million in 2001, a decrease of $0.3 million from 2000, primarily due to an increase in capital recoveries in Hydro partially offset by slightly higher salary and fringe benefit costs in 2001 and higher professional services related to Hydro's 2001 rate application. The amortization of costs in the Rate Stabilization Plan decreased from $13.9 million in 2000 to $11.2 million in 2001.

Depreciation expense was $44.5 million in 2001, a decrease of $3.2 million from 2000 primarily due to some major generating assets in Hydro being fully depreciated early in 2001. Total interest expense, which includes a debt guarantee fee, was $103.1 million in 2001, a reduction of $2.4 million from 2000, primarily due to higher interest earned and lower rates partially offset by higher debt balances.

Capital Expenditures

Expenditures for additions to fixed assets in 2001 amounted to $94.9 million compared to $52.8 million in 2000. The 2001 expenditures were for various additions to plant, transmission and distribution facilities throughout the province. Expenditures include $36.9 million for the Granite Canal project, $7.7 million related to the potential development of hydro projects in Labrador, $14.3 million for major transmission line upgrades and $10.0 million for a new microwave system. The capital program is financed from funds generated internally from operations and funds acquired through borrowing in the capital markets.

Dividends

Hydro commenced paying common dividends to the province in 1995. Hydro pays a dividend based on its net operating income and a further dividend based on the cash flow that Hydro receives from its investment in CF(L)Co, net of debt servicing costs related to the debt that Hydro incurred to finance its investment in CF(L)Co. The payments made by Hydro in 2001 were $43.3 million from net operating income and $10.0 million from its investment in CF(L)Co.

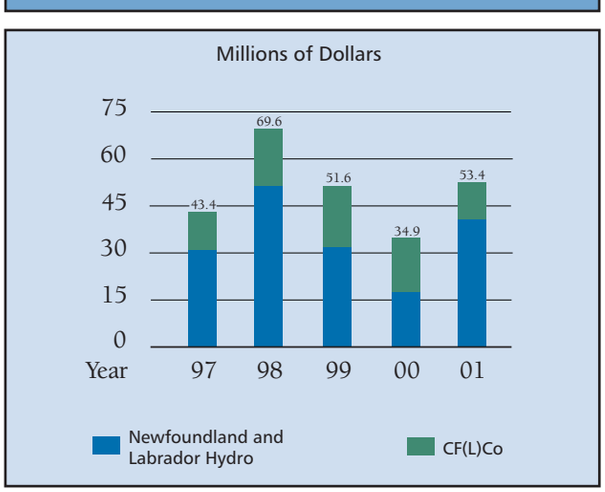
Debt

During 2001, there were two new debentures issued. The first was for $150 million carrying a coupon of 6.65% maturing in August 2031. The second was for $100 million carrying a coupon of 5.05% and maturing in December 2006. In addition, the Series W debenture matured in 2001. This debenture was for $150 million and carried a coupon of 10.75%. The retirement of this relatively high coupon bond and its replacement with lower cost debt, has enabled Hydro to realize a continued trend toward a reduction in its overall cost of debt.

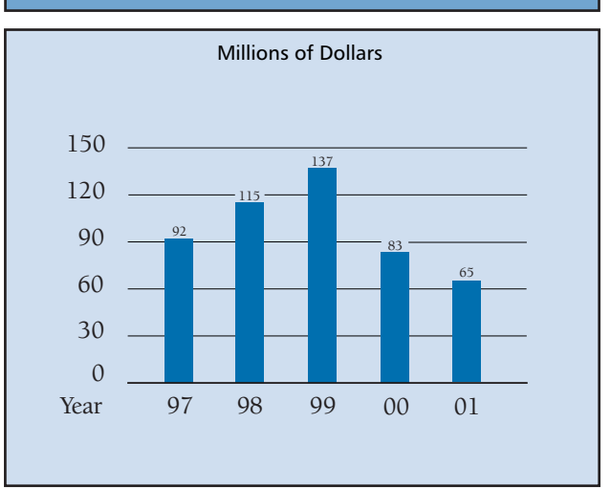
Total debt is as shown in the following table:

millions of dollars	**2001**	2000	Increase (Decrease)
Hydro			
Long-term debt	**1,122.3**	1,033.1	89.2
Promissory notes	**138.0**	120.8	17.2
	1,260.3	1,153.9	106.4
CF(L)Co			
Long-term debt	**180.7**	201.1	(20.4)
Total debt	**1,441.0**	1,355.0	86.0

Consolidated Net Income



Cash Flow From Operations



Segmented Information

Segmented operating results are as follows:

millions of dollars	**2001 Hydro**	**CF(L)Co**	**Total**	2000 Hydro	CF(L)Co	Total
Revenue						
Energy sales	**325.3**	**62.7**	**388.0**	303.2	64.2	367.4
Recovery of costs in RSP	**11.2**	**-**	**11.2**	13.9	-	13.9
	336.5	**62.7**	**399.2**	317.1	64.2	381.3
Expenses						
Operations and administration	**90.8**	**28.3**	**119.1**	93.2	26.2	119.4
Fuels	**50.2**	**-**	**50.2**	42.5	-	42.5
Amortization of RSP costs	**11.2**	**-**	**11.2**	13.9	-	13.9
Power purchased	**20.1**	**-**	**20.1**	20.4	-	20.4
Depreciation	**32.2**	**11.2**	**43.4**	35.5	11.0	46.5
Interest	**91.6**	**8.7**	**100.3**	94.2	9.1	103.3
	296.1	**48.2**	**344.3**	299.7	46.3	346.0
Income from operations	**40.4**	**14.5**	**54.9**	17.4	17.9	35.3
Interest on debt financing the CF(L)Co investment and other dedicated costs	**-**	**1.5**	**1.5**	-	0.4	0.4
Net income to Hydro	**40.4**	**13.0**	**53.4**	17.4	17.5	34.9

Financial Indicators (Hydro only)

Hydro calculates its debt/equity ratio and interest coverage on a non-consolidated basis. These are shown in the following table:

Year	Interest Coverage	Capital Structure % Debt	Equity
*2001	1.42	80	20
*2000	1.18	78	22
*1999	1.33	76	24
*1998	1.42	77	23
1997	1.23	80	20

* *Includes sales of recall energy to Hydro-Québec effective March 9, 1998.*

Outlook

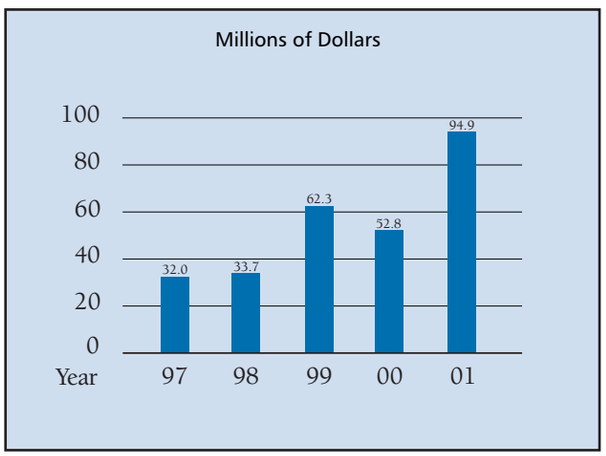
As a regulated utility, Hydro must receive approval for all proposed rate alterations for its retail, rural and island industrial customers from the Board of Commissioners of Public Utilities of the Province of Newfoundland and Labrador (PUB).

In May 2001, Hydro submitted an application to the PUB for a rate increase with a proposed implementation date of January 1, 2002.

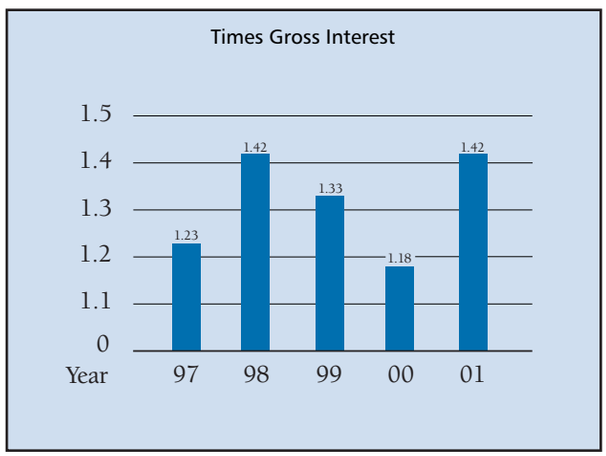
The hearing into the application to the PUB for an alteration in rates commenced in September 2001 and finished on January 29, 2002, with the conclusion of Oral Argument. Until an Order of the PUB is known, Hydro cannot determine the magnitude of the effect on its 2002 regulated earnings.

Throughout 2001, the Province of Newfoundland and Labrador has continued to examine the viability of hydro developments in Labrador.

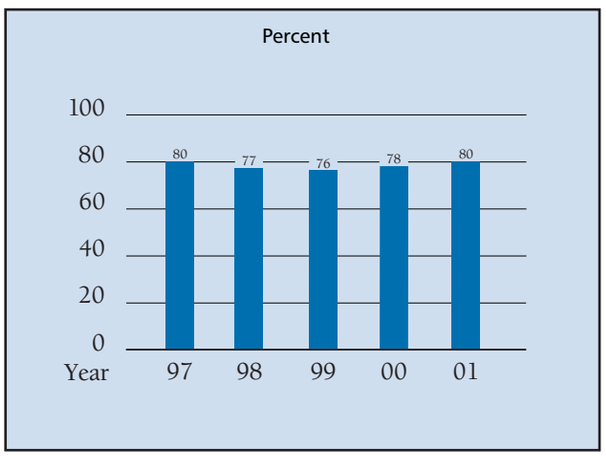
Capital Expenditures



Interest Coverage (Hydro only)



Debt To Total Capitalization (Hydro only)



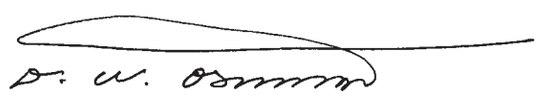
The accompanying consolidated financial statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 8, 2002. Financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

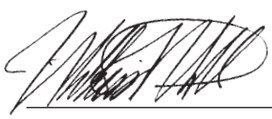
Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis, and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditor, Ernst and Young LLP, is to express an independent, professional opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditor's Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfils its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with Management, the internal auditors, and the external auditor to satisfy itself that each group has properly discharged its respective responsibility and to review the financial statements before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.



D. W. Osmond
Vice-President, Finance and Chief Financial Officer



William E. Wells
President and Chief Executive Officer

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2001 and the consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2001, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

St. John's, Newfoundland and Labrador
Canada
February 8, 2002

Ernst & Young LLP
Chartered Accountants

As at December 31 (millions of dollars)	**2001**	2000
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,566.8**	2,517.7
Less contributions in aid of construction	**109.9**	104.8
	2,456.9	2,412.9
Less accumulated depreciation	**707.6**	669.6
	1,749.3	1,743.3
Construction in progress	**88.7**	46.6
	1,838.0	1,789.9
Current assets		
Cash and cash equivalents	**1.1**	0.4
Short-term investments	**4.0**	4.1
Accounts receivable	**66.7**	62.2
Current portion of rate stabilization plan	**21.1**	11.5
Fuel and supplies at average cost	**46.3**	49.0
Prepaid expenses	**2.0**	2.5
	141.2	129.7
Long-term receivable (Note 3)	**1.1**	3.7
Sinking funds (Note 9)	**42.7**	35.4
Investments (Note 4)	**5.2**	9.3
Rate stabilization plan	**63.9**	24.1
Deferred charges (Note 6)	**147.2**	149.5
	2,239.3	2,141.6

See accompanying notes

As at December 31 (millions of dollars)	**2001**	2000
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,156.7**	1,043.3
Current liabilities		
Bank indebtedness	**2.1**	5.3
Accounts payable and accrued liabilities	**48.7**	35.1
Accrued interest	**25.5**	26.7
Long-term debt due within one year (Note 7)	**146.3**	190.9
Promissory notes (Note 7)	**138.0**	120.8
	360.6	378.8
Foreign exchange loss provision	**10.0**	9.0
Employee future benefits (Note 8)	**28.5**	27.1
Non-controlling interest in LCDC	**14.8**	14.8
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Note 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**100.0**	100.0
Retained earnings	**528.6**	528.5
	668.7	668.6
Commitments and contingencies (Note 11)	**-**	-
	2,239.3	2,141.6

See accompanying notes

On behalf of the Board:

Director

Director

Year ended December 31 (millions of dollars)	**2001**	2000
Revenue		
Energy sales	**374.8**	357.0
Recovery of costs in rate stabilization plan	**11.2**	13.9
Guaranteed winter availability	**7.5**	4.6
Rentals and royalties	**0.3**	0.3
Other	**3.3**	3.9
	397.1	379.7
Expenses		
Operations and administration	**119.1**	119.4
Fuels	**50.2**	42.5
Amortization of costs in rate stabilization plan	**11.2**	13.9
Power purchased	**15.6**	15.8
Depreciation	**44.5**	47.7
Interest (Note 10)	**103.1**	105.5
	343.7	344.8
Net income	**53.4**	34.9
Retained earnings, beginning of year	**528.5**	563.5
	581.9	598.4
Dividends	**53.3**	69.9
Retained earnings, end of year	**528.6**	528.5

See accompanying notes

Year ended December 31 (millions of dollars)	**2001**	2000
Cash provided by (used in)		
Operating activities		
Income before non-controlling interest	**53.4**	34.9
Adjusted for items not involving a cash flow		
Depreciation	**44.5**	47.7
Amortization of deferred charges	**1.6**	1.7
Rate stabilization plan	**(49.4)**	(1.1)
Other	**3.8**	3.1
	53.9	86.3
Change in non-cash balances related to operations		
Accounts receivable	**(2.3)**	0.7
Fuel and supplies	**2.7**	0.9
Prepaid expenses	**0.5**	(1.4)
Accounts payable and accrued liabilities	**6.2**	(7.1)
Accrued interest	**(1.2)**	(0.3)
Employee future benefits	**1.4**	2.0
Adjustment to deferred foreign exchange	**1.1**	0.9
Long-term receivable	**2.6**	0.5
	64.9	82.5
Financing activities		
Long-term debt issued	**250.0**	-
Long-term debt retired	**(185.9)**	(32.4)
Foreign exchange loss recovered	**7.8**	6.4
Increase in promissory notes	**17.2**	66.8
Dividends	**(53.3)**	(69.9)
	35.8	(29.1)
Investing activities		
Net additions to capital assets	**(94.9)**	(52.8)
Decrease in short-term investments	**0.1**	4.0
Increase in sinking funds	**(11.5)**	(10.7)
Decrease in investments	**4.1**	3.7
Additions to deferred charges	**(2.0)**	-
Change in accounts payable related to investing activities	**7.4**	2.2
	(96.8)	(53.6)
Net increase (decrease) in cash	**3.9**	(0.2)
Cash position, beginning of year	**(4.9)**	(4.7)
Cash position, end of year	**(1.0)**	(4.9)
Cash position is represented by		
Cash and cash equivalents	**1.1**	0.4
Bank indebtedness	**(2.1)**	(5.3)
	(1.0)	(4.9)

See accompanying notes

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the "province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and to conform with recommendations of the Board of Commissioners of Public Utilities ("PUB") of the province.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations (Excluding Sales by Subsidiaries)

The province enacted legislation in 1996 that changed the manner in which Hydro will be regulated. In future, the rates to be charged to all customers and Hydro's earnings on a rate of return basis, will be fully regulated. As well, Hydro's capital expenditure program is subject to review and approval by the PUB.

Rates charged rural customers do not recover the full costs of providing the service but Hydro recovers the resulting deficit from other customers.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited ("GIPCo"), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co") and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing, and investing policies of CF(L)Co be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co subsequent to the effective date of the shareholders' agreement.

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,000 kilowatts ("CF(L)Co Project"). A power contract with Hydro-Québec, dated May 12, 1969, ("Power Contract") provides for the sale of substantially all the energy from the CF(L)Co Project until 2041. CF(L)Co receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

The cost of Hydro's investment in CF(L)Co exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2001, $31.2 million (2000 – $30.1 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the province annually.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (the "Gull Island Project"), (see Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (the "Lower Churchill Development"), (see Note 4).

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances bearing interest rates of 2.15% to 6.09% per annum (2000 – 5.82% to 6.21%). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of funds borrowed.

Hydro has made no provision in its accounts to date for future removal and site restoration costs. The inclusion of these costs in the rate base is subject to the rate setting process.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching Stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co

CF(L)Co uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service Facilities	67 years
Other	5 to 100 years

CF(L)Co has made no provision in its accounts for future removal and site restoration costs as they cannot be estimated at this time.

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. The balance in the plan is amortized over a three-year period. Adjustments required in retail rates to cover the amortization of the balance in the plan do not require a reference to the PUB and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

1. Summary of Significant Accounting Policies (Cont'd)

Promissory Notes

Promissory Notes bear interest from 2.08% to 3.90% per annum (2000 – 5.70% to 5.99%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2000 – 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date, monetary assets and liabilities are translated using exchange rates in effect at that date.

(i) In the case of Hydro, foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Commencing in 1992, the PUB required Hydro to provide a $1.0 million annual provision for a foreign exchange loss on its Swiss Franc denominated debt. This provision is included in interest expense.

(ii) Under the provisions of the Power Contract, CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The recoverable portion of the unrealized foreign exchange loss is deferred until the settlement dates. The foreign exchange loss not recoverable under the Power Contract is being amortized to operations on a straight-line basis over the remaining life of the debt. Commencing in 2002, CF(L)Co will implement new recommendations from the Canadian Institute of Chartered Accountants whereby these unrealized gains and losses will be recognized in the current period, rather than being deferred and amortized.

Financial Instruments

Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs.

2. Capital Assets

	Capital Assets In Service	Contributions In Aid Of Construction	Accumulated Depreciation	Construction In Progress
millions of dollars		**2001**		
Generation Plant				
Hydroelectric	**1,240.1**	**20.5**	**245.2**	**40.0**
Thermal	**225.8**	**-**	**173.4**	**-**
Diesel	**58.7**	**8.3**	**21.7**	**3.3**
Transmission and Distribution	**666.2**	**56.7**	**140.8**	**1.5**
Service facilities	**22.0**	**-**	**9.1**	**-**
Project costs (Note 4)	**96.5**	**-**	**-**	**-**
Capital studies (Note 4)	**25.0**	**-**	**-**	**-**
Other	**232.5**	**24.4**	**117.4**	**43.9**
	2,566.8	**109.9**	**707.6**	**88.7**
millions of dollars		2000		
Generation Plant				
Hydroelectric	1,239.2	20.5	234.5	3.2
Thermal	223.1	-	166.8	1.5
Diesel	53.6	8.5	19.8	1.9
Transmission and Distribution	646.4	56.8	130.4	2.6
Service facilities	22.3	-	8.9	-
Project costs (Note 4)	96.7	-	-	-
Capital studies (Note 4)	24.9	-	-	-
Other	211.5	19.0	109.2	37.4
	2,517.7	104.8	669.6	46.6

Included in the above amounts are CF(L)Co assets in service amounting to $646.2 million (2000 – $623.2 million) which are pledged as collateral for long-term debt.

3. Long-Term Receivable

The long-term receivable from Hydro-Québec bears interest at 7% per annum and is receivable over a four-year period which commenced in September 2000. The current portion of $1.1 million (2000 – $1.1 million) is included in accounts receivable.

4. Investments

millions of dollars	**2001**	2000
Lower Churchill Option	**5.2**	5.2
Government of Canada Coupons, at cost (market value 2000 – $4.1)	**-**	4.1
	5.2	9.3

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (the "Principal Agreement"), between the province and the Government of Canada. The province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (the "Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the province, (the "Option Agreement"). The purchase price in respect of GIPCo's assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the province in consideration of the Water Rights and the province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2002, and it is not anticipated that there will be any loss upon sale of GIPCo's assets to LCDC.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the province.

5. Joint Venture

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2001, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2001.

millions of dollars	**2001**	2000
Current assets	**34.9**	31.5
Long-term assets	**395.0**	412.8
Current liabilities	**40.2**	36.9
Long-term liabilities	**148.8**	173.1
Revenues	**58.6**	60.0
Expenses	**48.4**	46.7
Net income	**10.2**	13.3
Cash provided by (used in)		
Operating activities	**28.3**	28.0
Financing activities	**(25.0)**	(24.5)
Investing activities	**1.2**	1.1

6. Deferred Charges

millions of dollars	**2001**	2000
Unamortized debt discount, financing expenses and other	**13.8**	13.5
Foreign exchange losses		
Hydro – Realized	**96.3**	96.3
CF(L)Co		
Recoverable under the Power Contract	**41.2**	41.1
Unrecoverable portion to be amortized	**5.1**	5.7
	142.6	143.1
Less current portion recoverable included in current assets	**9.2**	7.1
	133.4	136.0
	147.2	149.5

7. Long-Term Debt

	Hydro	**CF(L)Co**	**Total**	Hydro	CF(L)Co	Total
millions of dollars		**2001**			2000	
Summary of long-term debt						
Long-term debt	**1,122.3**	**180.7**	**1,303.0**	1,033.1	201.1	1,234.2
Less payments due within one year	**114.4**	**31.9**	**146.3**	162.9	28.0	190.9
	1,007.9	**148.8**	**1,156.7**	870.2	173.1	1,043.3

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2002	2003	2004	2005	2006
	146.3	48.9	31.4	29.6	128.7

The payments due within one year include sinking fund requirements of $7.3 million (2000 – $5.8 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2001**	2000	
W	10.75	1991	2001	**-**	150.0	
Z	5.25	1997	2002	**100.0**	100.0	
AC	5.05	2001	2006	**100.0**	-	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**150.0**	-	(a)
Total debentures				**1,125.0**	1,025.0	
Less sinking fund investments in own debentures				**37.9**	33.7	
				1,087.1	991.3	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**31.0**	36.5	
Other				**4.2**	5.3	
				1,122.3	1,033.1	
Less payments due within one year				**114.4**	162.9	
				1,007.9	870.2	

(a) Sinking funds have been established for these issues.

Promissory notes, debentures, and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the province. The province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the province, outstanding as of the preceding December 31.

7. Long-Term Debt (Cont'd)

CF(L)Co

millions of dollars	**2001**	2000
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $81.8; 2000 – U.S. $98.8)	**130.2**	148.1
7.875% Series B due December 15, 2007	**8.3**	10.0
General Mortgage Bonds		
7.500% due December 15, 2010	**42.2**	43.0
	180.7	201.1
Less payments due within one year	**31.9**	28.0
	148.8	173.1

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There has been no contingent repayments in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however, fixed sinking fund payments are estimated to average $25.0 million in each of the years 2002 to 2006 inclusive.

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999 places additional restrictions on dividends, based on cash flow.

8. Employee Future Benefits

Pension Plan

Employees participate in the province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of $3.6 million (2000 – $3.2 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. Information about these plans is as follows:

millions of dollars	**2001**	2000
Accrued benefit obligation		
Balance at beginning of year	**27.1**	25.1
Current service cost	**0.9**	0.9
Interest cost	**2.0**	1.8
Benefits paid	**(1.5)**	(0.7)
Balance at end of year	**28.5**	27.1
Plan deficit	**28.5**	27.1

The significant actuarial assumptions used in measuring the company's accrued benefit obligations include a discount rate of 7.0% and an average rate of compensation increase of 3.5%. In addition, in determining the expected cost of health care benefits, it was assumed that health care costs will increase by 12.0% in 2000 and decrease gradually to 5.0% in 2007 and remain level thereafter.

The net benefit plan expense is as follows:

millions of dollars	**2001**	2000
Current service cost	**0.9**	0.9
Interest cost	**2.0**	1.8
Net benefit plan expense	**2.9**	2.7

9. Financial Instruments

Fair Value

The estimated fair values of financial instruments as at December 31, 2001 and 2000 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
millions of dollars	**2001**		2000	
Financial Assets				
Sinking funds	**42.7**	**43.5**	35.4	36.9
Long-term receivable including amount due in one year	**2.2**	**2.3**	4.9	5.0
Financial Liabilities				
Long-term debt including amount due in one year	**1,303.0**	**1,489.9**	1,234.2	1,416.6

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest, and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2001, of the total accounts receivable balance outstanding, approximately 38.5% (2000 – 43.0%) is due from a regulated utility and 39.1% (2000 – 33.8%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes, and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2028. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 5.80% to 10.55% (2000 – 5.80% to 10.55%).

10. Interest Expense

millions of dollars	**2001**	2000	
Gross interest			
Long-term debt	**114.4**	113.5	
Promissory notes	**6.2**	5.7	
	120.6	119.2	
Amortization of debt discount and financing expenses	**1.3**	1.3	
Provision for foreign exchange losses	**1.0**	1.0	
	122.9	121.5	
Less			
Recovered from Hydro-Québec	**14.0**	13.3	(a)
Interest capitalized during construction	**5.1**	3.7	
Interest earned	**11.8**	9.6	
Net interest expense	**92.0**	94.9	
Debt guarantee fee	**11.1**	10.6	
Net interest and guarantee fee	**103.1**	105.5	

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

11. Commitments and Contingencies

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements, is approximately $1.6 million (2000 – $0.3 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have commenced against Hydro by one of its customers claiming approximately $23.0 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $80.9 million at December 31, 2001 (2000 – $47.4 million). Hydro has commenced development of a hydroelectric generating station at Granite Canal. Total project cost is expected to be approximately $134.6 million, with an anticipated in-service date of June 2003. As at December 31, 2001, $40.0 million had been expended on this project.

(d) In connection with the Granite Canal development, Hydro has issued an irrevocable Letter of Credit, in the amount of $5.4 million to ensure compliance with the terms of the Fish Habitat Compensation Agreement between Hydro and the Department of Fisheries and Oceans.

12. Comparative Figures

Certain of the 2000 comparative figures have been reclassified to conform with the 2001 financial statement presentation.

Year ended December 31 (millions of dollars)	**2001**	2000	1999[1]	1998	1997
OPERATING RESULTS					
Revenue					
Energy sales	**374.8**	357.0	384.4	391.8	376.9
Rentals and royalties	**0.3**	0.3	0.4	0.5	0.5
Recovery of costs in RSP	**11.2**	13.9	15.4	10.9	7.2
Guaranteed winter availability	**7.5**	4.6	3.6	-	-
Other	**3.3**	3.9	2.4	1.6	1.2
	397.1	379.7	406.2	404.8	385.8
Expenses					
Operations and administration	**119.1**	119.4	112.3	114.1	106.9
Amortization of RSP costs	**11.2**	13.9	15.4	10.9	7.2
Fuels and power purchased	**65.8**	58.3	48.2	34.0	46.4
Depreciation	**44.5**	47.7	51.3	50.5	48.0
Interest	**103.1**	105.5	107.6	117.8	128.4
	343.7	344.8	334.8	327.3	336.9
Income from operations	**53.4**	34.9	71.4	77.5	48.9
Write down of capital assets	**-**	-	16.7	-	-
Net income before non-controlling interest	**53.4**	34.9	54.7	77.5	48.9
Non-controlling interest	**-**	-	3.1	7.9	5.5
Net income	**53.4**	34.9	51.6	69.6	43.4
Contributions to net income					
Hydro Corporate	**40.4**	17.4	31.7	51.2	30.9
CF(L)Co	**13.0**	17.5	19.9	18.4	12.5
FINANCIAL POSITION					
Total current assets	**141.2**	129.7	137.8	164.0	146.3
Total current liabilities	**360.6**	378.8	163.1	294.4	432.8
Net working capital	**(219.4)**	(249.1)	(25.3)	(130.4)	(286.5)
Capital assets	**2,545.6**	2,459.5	2,414.9	2,710.0	2,677.5
Accumulated depreciation	**707.6**	669.6	628.6	719.3	669.2
Capital assets, net	**1,838.0**	1,789.9	1,786.3	1,990.7	2,008.3
Sinking funds	**42.7**	35.4	28.8	113.3	144.3
Other assets	**217.4**	186.6	188.1	255.1	245.9
Long-term debt	**1,156.7**	1,043.3	1,226.4	1,398.5	1,334.0
Other liabilities	**53.3**	50.9	25.3	138.6	139.2
Shareholder's equity	**668.7**	668.6	726.2	691.6	638.8
EMPLOYEES AT YEAR END					
Permanent	**1,026**	1,063	1,069	1,078	1,097
Temporary	**203**	219	207	196	156
Total	**1,229**	1,282	1,276	1,274	1,253

(1) Effective June 18, 1999, Hydro adopted the proportionate consolidation method of accounting for its interest in CF(L)Co (65.8%).

Years ended December 31	**2001**	2000	1999	1998	1997
INSTALLED GENERATING CAPACITY (rated MW)					
CF(L)Co	**5,428**	5,428	5,428	5,428	5,428
TWINCo	**225**	225	225	225	225
Hydro					
Hydraulic	**899**	899	899	899	899
Thermal	**645**	645	645	645	645
Diesel	**57**	55	55	58	58
Total	**7,254**	7,252	7,252	7,255	7,255
ELECTRIC ENERGY GENERATED, NET (GWh)					
CF(L)Co	**32,910**	35,108	34,508	37,543	33,727
Hydro					
Hydraulic	**3,959**	5,016	4,801	4,260	4,628
Thermal	**2,095**	966	914	1,255	1,528
Diesel	**46**	43	41	41	41
Total	**39,010**	41,133	40,264	43,099	39,924
ELECTRIC ENERGY SALES (GWh)					
CF(L)Co					
Export	**28,159**	30,268	29,674	32,793	30,301
Hydro					
Utility	**4,423**	4,263	4,084	4,157	4,306
Rural	**832**	842	830	811	815
Industrial	**1,528**	1,607	1,343	1,286	1,660
Export	**1,558**	1,494	1,731	1,344	-
Total	**36,500**	38,474	37,662	40,391	37,082
AVERAGE SALES REVENUE (cents per kWh)					
CF(L)Co					
Export	**0.27**	0.27	0.27	0.27	0.27
Hydro					
Utility	**4.50**	4.49	4.49	4.49	4.51
Rural	**5.60**	5.53	5.54	5.46	5.45
Industrial	**3.14**	2.90	3.58	3.26	3.24
Export	**2.22**	2.22	2.22	2.22	-
TRANSMISSION LINES (kilometres)					
CF(L)Co					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,531**	1,531	1,531	1,531	1,531
138 kV	**1,482**	1,482	1,482	1,482	1,482
69 kV	**636**	636	636	636	636
Total	**4,688**	4,688	4,688	4,688	4,688
PEAK DEMAND (MW)					
CF(L)Co System	**5,637**	5,606	5,590	5,602	5,584
Hydro System	**1,262**	1,240	1,265	1,295	1,229

Newfoundland and Labrador Hydro

Dean T. MacDonald

Senior Vice-President
Rogers Communications

Brian Maynard

Deputy Minister
Mines and Energy

Terry Goodyear

Professional Engineer
(Retired)

Elmer Harris

Executive
(Retired)

Barbara Fong

Executive Vice-President
Instrumar Limited

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Electrician
Wabush Mines

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Nexus Consultants

Mark Dobbin

Chairman and
Chief Executive Officer
Vector Aerospace
Corporation

J. Wayne Trask

Chairman and
Chief Executive Officer
Corporate Ventures
Incorporated

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President and
Chief Executive Officer
Newfoundland and
Labrador Hydro

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Chief Executive Officer
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Corporation Limited

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Business Executive

Twin Falls Power Corporation Limited

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President

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and Energy
Cliffs Mining Company

Maurice McClure
Manager, Financial Services
Iron Ore Company of
Canada

Grant Goddard
Vice-President, Strategic
Planning and Implementation
Iron Ore Company of
Canada

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General Manager
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and Chief Financial Officer
Newfoundland and
Labrador Hydro

David W. Reeves
Vice-President, Transmission
and Rural Operations
Newfoundland and
Labrador Hydro

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Vice-President, Production
Newfoundland and
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John Sanders
President
Wabush Mines

Lower Churchill Development Corporation Limited

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David Burpee

James R. Haynes

Gull Island Power Company Limited

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Chief Financial Officer

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Secretary

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Corporate Controller

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Treasurer

Gerald C. Bowers
Assistant Treasurer

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Chief Financial Officer

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Chief Executive Officer

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Secretary

2001 Installed Generating Capacity

Megawatts (MW)

The Hydro Group

CF(L)Co

Labrador

Interconnected

Hydraulic

Churchill Falls	5,428

Hydro

Labrador

Interconnected

Thermal (Diesel)

Happy Valley-Goose Bay	11.7
Mud Lake	0.2

Thermal (Gas Turbine)

Happy Valley-Goose Bay	27.0

Rural Isolated

Thermal (Diesel)

16 Sites	22.2

Black Tickle
Cartwright
Charlottetown
Davis Inlet
Hopedale
L'Anse-au-Loup
Makkovik
Mary's Harbour
Nain
Norman Bay
Paradise River
Port Hope Simpson
Postville
Rigolet
St. Lewis
Williams Harbour

Island

Interconnected

Hydraulic

Bay d' Espoir	604
Cat Arm	127
Upper Salmon	84
Hinds Lake	75
Paradise River	8
Snooks Arm/ Venams Bight	1
Roddickton	0.4

Thermal (Oil)

Holyrood	490

Thermal (Gas Turbine)

Hardwoods	54
Stephenville	54
Holyrood	15

Thermal (Diesel)

Hawke's Bay	5
Roddickton/ St. Anthony	9.7

Rural Isolated

Thermal (Diesel)

9 Sites	7.8

François
Grey River
Harbour Deep
Little Bay Islands
McCallum
Petites
Ramea
Rencontre East
St. Brendan's

Legend

- Generating Station
- Terminal Station
- Diesel Plant

Transmission Lines

- 735-kV
- 230-kV
- 138-kV
- 69-kV
- Low Voltage
- Customer-Owned

2001 Gross Island Interconnected Energy Supply

Gigawatt hours (GWh)

Hydraulic Generation	
Bay d' Espoir	2,400
Cat Arm	685
Upper Salmon	536
Hinds Lake	317
Paradise River	30
Mini Hydro	6
	3,974
Percentage of Total Energy Supply	62%

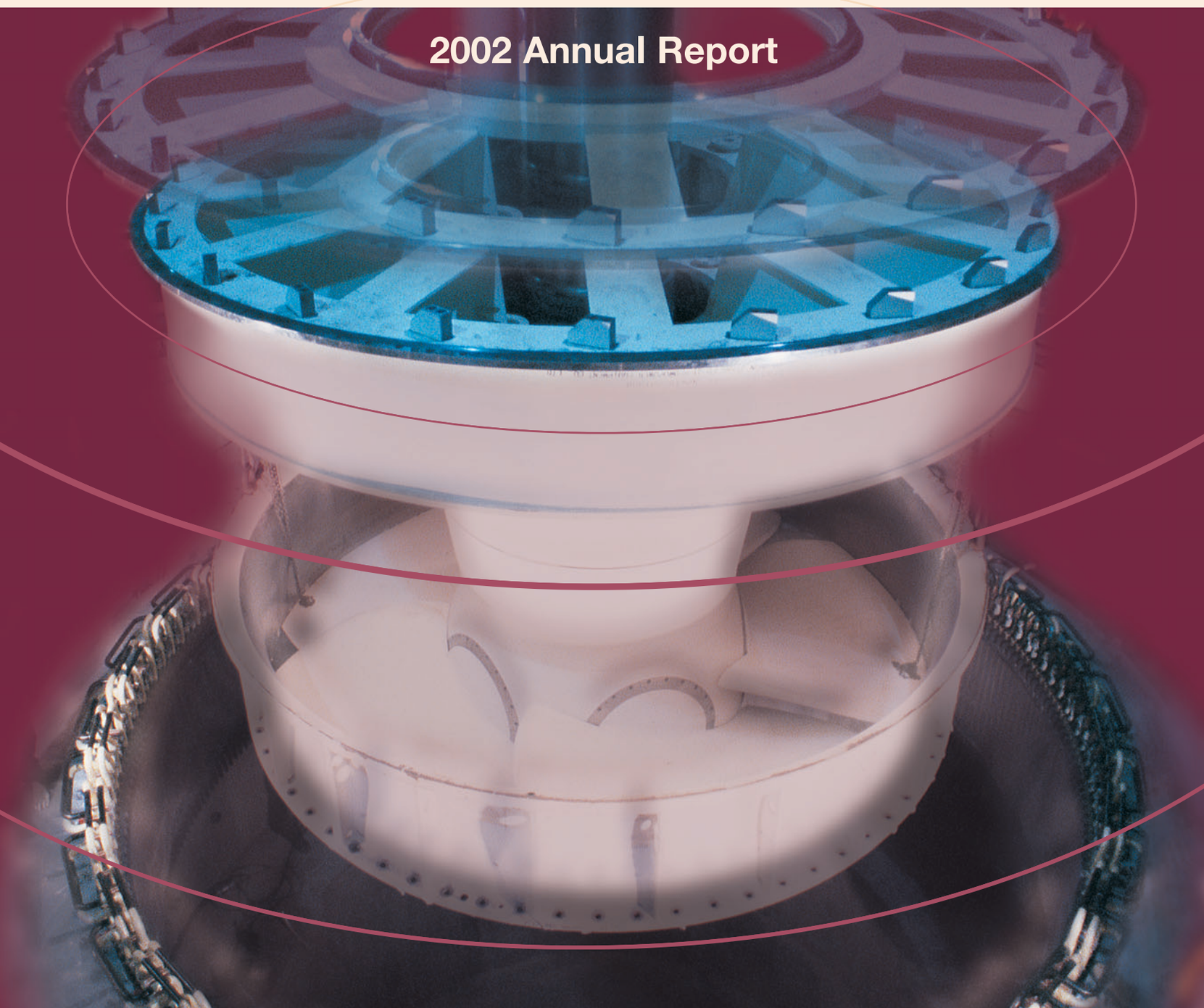
Hydraulic Power Purchase	170
Percentage of Total Energy Supply	3%
Thermal Generation	
Holyrood	2,218
Gas Turbine and Diesel	1
	2,219
Percentage of Total Energy Supply	35%


HYDRO
THE POWER OF
COMMITMENT

Newfoundland and Labrador Hydro

HYDRO
THE POWER OF COMMITMENT

2002 Annual Report



MISSION

Newfoundland and Labrador 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.

Our skilled and committed employees will use innovative methods and technologies and will maintain high standards of safety and health and environmental responsibility.

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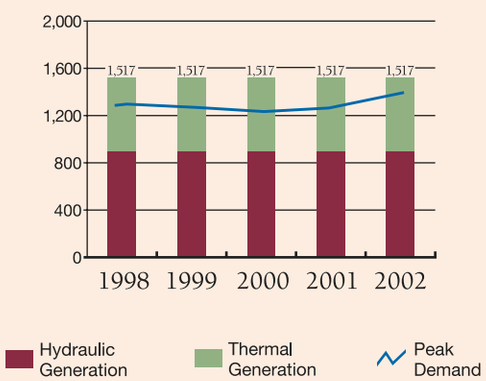
HIGHLIGHTS

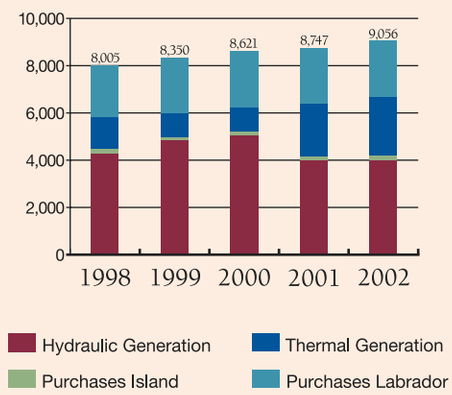
Island Interconnected System
Gross Generating Capacity and Peak Demand

Megawatts



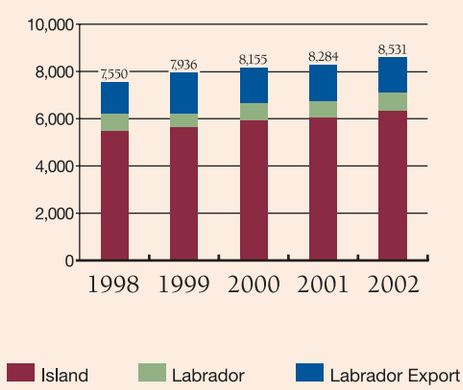
Interconnected Systems
Gross Energy Generated and Purchased

Gigawatt Hours



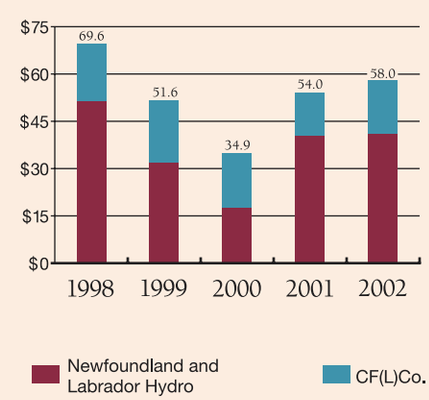
Interconnected Systems Energy Sales

Gigawatt Hours

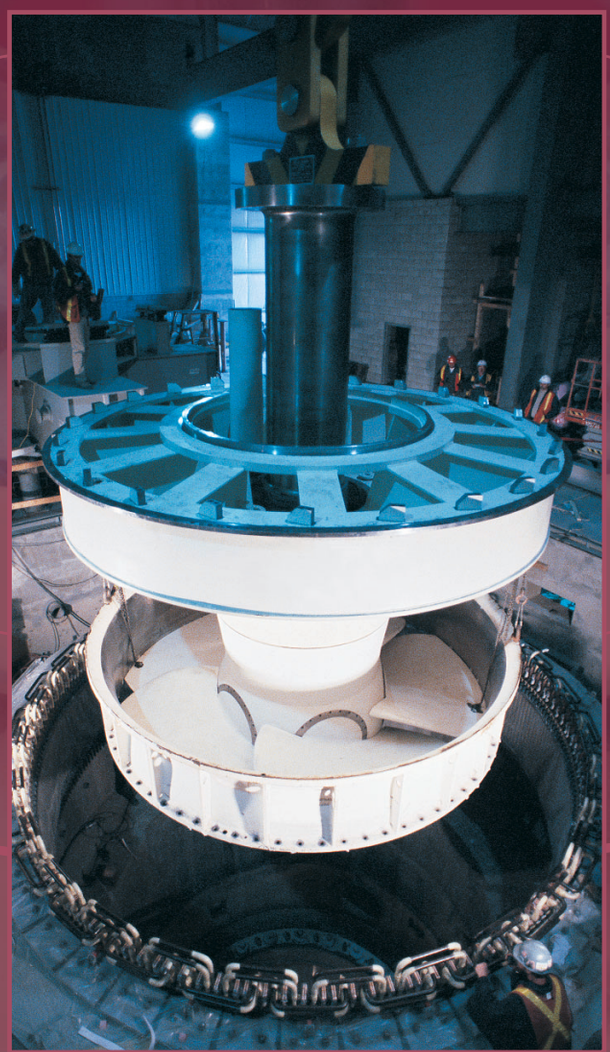


Consolidated Net Income

Millions of Dollars



MESSAGE FROM THE PRESIDENT



Lowering the turbine runner into position at the new Granite Canal hydroelectric generating plant.

President and Chief Executive Officer William E. Wells

The past year has been one of challenge and adjustment within the Hydro Group, as we continue to pursue our strategic goals and objectives in the fulfillment of our mission to provide cost-effective and reliable energy services to our customers, for the benefit of all the people of the Province.

As the results indicate, the financial performance of the Hydro Group in 2002 exceeded expectations. This was despite the fact that new rates for our regulated activity did not come into effect until September 1, 2002.

The Order of the Board of Commissioners of Public Utilities ("PUB") issued on June 7, 2002, following a lengthy and complex hearing, was Hydro's first as a fully regulated utility. It outlines the regulatory framework, which will apply to Hydro's regulated activities in the future. The Order covered more than 90 policy and operational issues. In the aftermath of the Order, we are dealing with the significant policy and operational issues that will affect the position of Hydro at its next General Rate Application that must be filed in 2003 by Order of the PUB.

The combination of lower reservoir inflows, increased production to meet demand and soaring fuel prices for Bunker "C" fuel will have a significant impact on costs and, therefore, rates paid by our industrial and utility customers, a matter which will become more evident throughout 2003.

The Holyrood Thermal plant, which is an integral component of the Island Interconnected System, had a record gross production of 2,511 GWh in 2002. More importantly, the plant was available to produce as required and operated at record levels of efficiency. On the negative side, the average cost per barrel of Bunker "C" fuel for 2002 was $32.50 and 3.7 million barrels were required to meet the demand. While the PUB Order

raised the purchase price of Bunker "C" fuel in Hydro rates from $12.50 to $25.91 per barrel, effective September 1, 2002, the outstanding balance in the Rate Stabilization Plan continues to increase substantially due to higher fuel prices.

The strategic focus on improving corporate performance continued in 2002 with the development of a comprehensive program to assess business processes across all departments, eliminate waste and identify the process changes required to ensure that corporate performance is optimized, as determined by Key Performance Indicators ("KPI"). The development of appropriate performance indicators was an essential element of the strategy to ensure that eventually performance at every level throughout the Corporation can be measured. Identified changes in process and work methods are ready for implementation at the beginning of 2003, particularly in supply chain management. The business improvement process will continue enabling all employees to ensure that efficiencies in operations and costs, over which they have control, are maximized to the benefit of consumers.

As production levels rise, over the past ten years the Corporation's workforce has declined by 21%. The Corporation is maintaining the appropriate levels of compensation through salaries, wages and benefits for all of its employees, while maximizing the efficiency of its operations. In 2002, the four collective agreements applicable to employees within the Hydro Group, members of the IBEW, were renewed for three-year terms.

Capital expenditures on system improvements over the past five years have been $348 million. In 2002, the multi-year, $45 million upgrade of the transmission line from Sunnyside to St. John's was completed, providing significant increased margins of security to a large percentage of the Island population on the Avalon Peninsula from any disruption due to major storms.

Construction of the $135 million, 40 MW Granite Canal powerhouse continued on time and within budget. This unit will come on stream mid-2003 and provide a cost-effective supply to the Island Interconnected System for many years to come.

The publication of our second annual Environmental Performance report in June is reflective of the significant progress made within the Hydro Group on a very proactive commitment to environmental stewardship. At year's end, all operations in the Hydro Group have been registered or are in compliance with ISO 14001 standards. The registration of the transmission and rural operations division will be completed in 2003.

We are equally as determined to achieve the equivalent success within our corporate Safety and Health Program and have, as a target, the achievement of an exemplary safety record.

The Hydro Group is a significant contributor to the provincial economy, not only in the supply of 84% of the requirements for reliable and cost-effective energy. The Hydro Group generated profits of $58 million in 2002; the total payment to the Government of Newfoundland and Labrador in dividends and guarantee fees was $140.2 million.

In providing services to its 35,000 retail customers throughout the rural areas of the Province, and supplying the requirements of its industrial customers and Newfoundland Power serving 219,000 Island customers, all the employees of the Hydro Group are aware of the significant role they play in the economic fortunes of our Province and the responsibility entrusted to them. The results of their efforts in 2002 are outlined in this report.

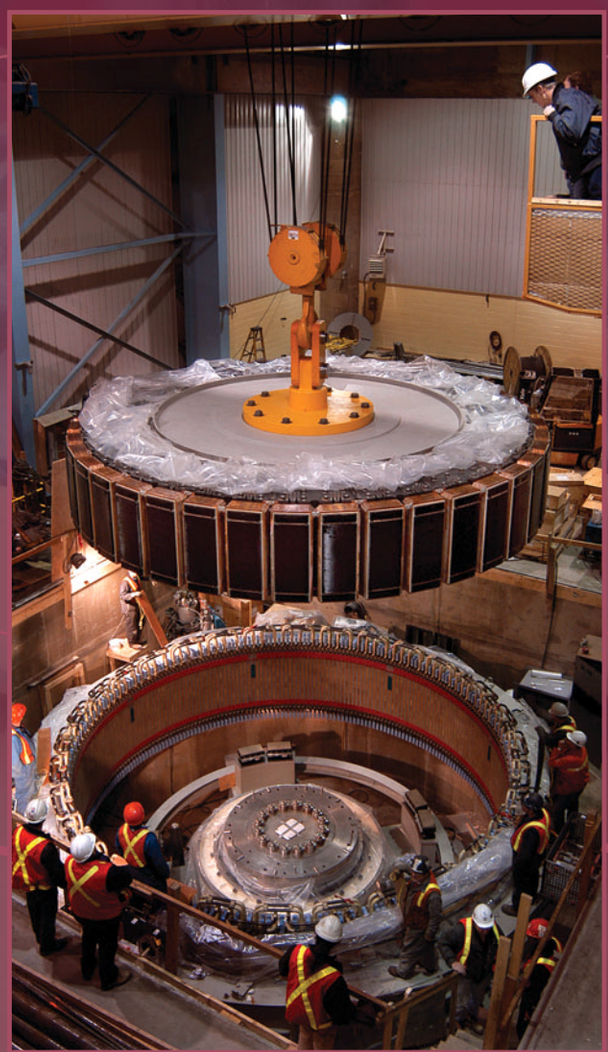
I should like to note the retirement of Derek W. Osmond, Vice-President of Finance and Chief Financial Officer, as of December 31, 2002, following a 27-year career with the Hydro Group. I extend my best wishes to Derek for a healthy and well-deserved retirement.

Mr. J. Wayne Trask retired from the Board of Directors of Hydro at the end of 2001. Mr. Victor L. Young resigned from the Board of Directors of CF(L)Co. in June, and Messrs. Dean T. MacDonald and Mark Dobbin resigned from the Board of Directors of Hydro in November 2002. As members of their respective boards, they made a significant contribution during their term of office and I should like to thank them for their support and assistance. To the directors of the Hydro and CF(L)Co. Boards I also extend my appreciation for their ongoing support and commitment during the past year.

Finally, on behalf of Board members and Executive management, I express our gratitude to all employees of the Hydro Group for their contribution throughout the year.

William E. Wells
President and Chief Executive Officer

YEAR IN REVIEW



Lowering the generator rotor into position at the new Granite Canal hydroelectric generating plant.

Newfoundland and Labrador Hydro engaged in a number of important initiatives and reached several significant milestones in 2002. From a year of record sales to the installation of the turbine/generator at Granite Canal, the past year has been quite productive.

ENERGY SALES AND PRODUCTION

In 2002, Hydro experienced record sales on its Island and Labrador interconnected systems. Combined sales totaled 7,100 GWh. This is a 5.5% increase over 2001 and a 5.4% increase over the record set in 1997. With the second consecutive year of below-average inflows into the Island hydro reservoirs, gross production from the Holyrood Thermal generating station set an all time high of 2,511 GWh. This is a 13% increase over 2001 and a 9% increase over the previous high set in 1987. Higher production requirements from the Holyrood facility also enabled us to establish an efficiency record of 648 kWh per barrel (net), a 2.5% increase over the previous record set in 2001. Net production increased at Churchill Falls to 35,516 GWh, a 7.9% increase over the previous year.

On January 31, a record peak of 1,403 MW was established on the Island Interconnected System. This was a significant increase over the 1,318 MW peak set in 1996.

GENERAL RATE APPLICATION

On June 7, 2002, the Board of Commissioners of Public Utilities ("PUB") issued its decision on Hydro's General Rate Application ("GRA"). The decision reflected the complexity of the lengthy hearing (over a 19-week period) and some 20,000 pages of evidence filed.

General rate increases became effective September 1, 2002, and included a 3.6% increase for residential customers on the Island Interconnected Rural and Isolated Systems.

The primary issue affecting cost was the adjustment of Bunker "C" fuel prices in rates from $12.50 a barrel set in 1992 to $25.91 a barrel to more properly reflect current fuel costs.

Consumers and industrial customers are protected from fluctuations in fuel prices impacting monthly bills by the Rate Stabilization Plan ("RSP"). Bunker "C" fuel is used by Hydro at the Holyrood Thermal plant. However,

escalating fuel costs had resulted in higher outstanding balances in the RSP. The PUB froze the outstanding balances of August 31, 2002, and directed that it be recovered over a five-year period starting in 2003. Balances in the new plan have increased beyond expectation since September as actual prices for Bunker "C" fuel have exceeded forecast prices to date. Outstanding balances in the new account are to be recovered from ratepayers over a two-year period beginning in 2004.

Hydro will be filing another GRA in 2003 to recover the cost of new sources of generation coming on-stream in 2003 to meet system requirements.

RELIABILITY

The Avalon Peninsula transmission upgrade program began in 1997-1998 when Hydro Engineering staff established a higher ice and wind loading criteria for these major 230 kV lines. Since their construction in the 1960's, these lines have been subjected to more severe ice and wind conditions than anticipated at the original design stage. This caused significant damage and more frequent lengthy power interruptions over the years, most recently in 1994.

The redesign of the steel tower transmission lines from Sunnyside to St. John's involved reconductoring, re-insulation, addition of new towers and strengthening of existing towers. Construction was completed in 2002 at a total capital cost of $45 million over the six-year period.

NEW GENERATION

The Granite Canal hydroelectric project had a busy construction year. All of the civil structures were virtually completed, and the turbine/generator was put in place. The 40 MW project is within budget and on schedule for in-service in June 2003.

We also successfully negotiated two supply contracts with Corner Brook Pulp and Paper and Abitibi-Consolidated. These companies have completed a co-generation project and hydro generation project respectively. This additional capacity, along with our Granite Canal plant, will provide a total of 87 MW to the Island interconnected grid to meet the anticipated increased demand.

At the request of Government, Hydro had a feasibility study conducted to assess the potential of wind generation to provide energy to the Island Interconnected System. The potential for a wind generation facility is currently being assessed.

CUSTOMER SERVICES

In 2002 we continued to survey residential customers in order to measure their satisfaction with the service provided. As well, a satisfaction survey of commercial customers was completed and will be used for future reference against the benchmarking study completed in 2001. The Customer Satisfaction Index for residential customers improved for the third consecutive year, increasing from 7.6 in 2000 and 7.9 in 2001 to 8.1 in 2002. Information obtained in these surveys will assist us in exploring new opportunities to improve customer service.

In response to customer requests for payment options, Hydro implemented an equal payment plan and a pre-authorized payment plan for residential customers on July 1, 2002. By mid-2003, customers will not only have the option of speaking to a customer services representative, but will also be able to access their account information and receive power outage information automatically over the Internet or by interactive voice response.

Recognizing the need for continual energy conservation, Hydro has developed a multi-year energy conservation initiative branded "***HYDROWISE***". The objectives of the initiative are to make information available to help customers in the wise use of electricity and to encourage customer participation in response to various applications that address their individual needs. Hydro has also partnered with the Conservation Corps of Newfoundland and Labrador to provide specialized energuide and energy audit services to customers.

ENVIRONMENT

One of our most significant achievements this year was to attain consistency of the Environmental Management Systems ("EMS") in all regions of the Transmission and Rural Operations Division with the ISO 14001 EMS standard. With this, all environmental issues facing the Hydro Group of Companies are managed through this international standard. In addition to being consistent with the ISO 14001 standard, all of our EMS management areas are certified, except the Transmission and Rural Operations Division, which will be registered for certification in 2003.

Being recognized for our accomplishments brings a sense of pride to all of us. Hydro was awarded the business category award in the Newfoundland and Labrador Environmental Awards program. We were cited for "the exemplary attitude and concern for the environment

through sound environmental management policy and demonstrated action to prevent and reduce pollution". This recognition is a reflection of the diligent work efforts and contributions of all employees.

The Granite Canal hydroelectric project provides many opportunities for us to demonstrate our ability to harness a natural resource in an environmentally responsible manner. It is natural to expect a project of this nature to require extensive environmental work such as caribou monitoring, fish telemetry and raptor studies. By far, the most significant environmental aspect of the project has been the design and construction of a fish habitat compensation facility. The need to replace spawning and rearing habitat for fish was identified, as the new passage of water from the plant would eliminate this habitat that existed prior to the development of the project. Approval from the Department of Fisheries and Oceans was obtained to construct the habitat. This multi-million dollar feature is a highlight of the project and unique in Canada.

SAFETY

The provision of a safe and healthy work place for all employees continues as a key priority. The Hydro Group's comprehensive Safety and Health Program based on industry best practices and our own internal standards was converted to a web-based electronic format in 2002 in preparation for inclusion in the Corporate Intranet. Conversion to a web format will provide on-line access to information for all employees regardless of their work location.

Hydro's safety performance in 2002, as compared with our peers within the Canadian Electricity Association ("CEA"), continued to be favourable with respect to All Injury Frequency, Disabling Injury Frequency and Injury Severity Rating. Our goal is to achieve the best possible safety record.

CHURCHILL FALLS

In 2002, we had the benefit of higher inflows to our reservoirs, resulting in an above-average 36.6 TWhrs of energy produced, at an overall load factor of 75%.

The Guaranteed Winter Availability Contract ("GWAC"), which provides for the sale of additional capacity outside the power contract to Hydro-Québec, contributes additional revenue to the Corporation. In 2002, 97.2% of the possible revenue from additional capacity was received under the Agreement.

In the first year of a three-year project, renovation of the Donald Gordon Centre began including disabled access, fire safety and ventilation improvements. The Centre is the largest building in Churchill Falls and houses a hotel, restaurant, school, library, supermarket, retail sales area, post office and recreation facilities.

POLE PURCHASE AGREEMENT

On December 4, 2002, Hydro and Aliant signed a Support Structures Purchase Agreement for Hydro's purchase of all the Aliant-owned joint use poles in Hydro's service territory in Newfoundland and Labrador.

Aliant has agreed to pay an annual rental fee per pole for the communication space it occupies on all joint use poles. This fee will escalate over the term of the Agreement, and the Agreement will renew automatically for successive ten-year terms unless one of the parties terminates the Agreement.

ELECTRICITY POLICY REVIEW

In late March, the Government released its Electricity Policy Review ("EPR"). Hydro welcomed the opportunity to reflect on the future of the electricity industry in the Province and believes that there are opportunities to assist in restraining cost pressures and changes that will help the system to be more efficient in the years ahead. As part of the consultation process, Hydro submitted a report in June outlining its position on the various proposals contained in the EPR.

CLIMATE CHANGE EDUCATION CENTRE

In June, the Climate Change Education Centre was officially opened. The Centre is a project of the Conservation Corps of Newfoundland and Labrador, aimed at identifying key areas in educating the public on climate change and influencing the role we can play in meeting this global challenge. Hydro is proud to be the corporate sponsor of this project. The other sponsors of the Centre are the Province of Newfoundland and Labrador and Environment Canada. This project brings together partners from government, business, environmental and health organizations, educational institutions, community groups and individuals in the development of an information and support centre for climate change education and outreach activities in Newfoundland and Labrador.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis highlights the primary factors that have an impact on the financial results and operations of the Corporation. It should be read in conjunction with the audited financial statements and the accompanying notes.

Newfoundland and Labrador Hydro ("Hydro") is a Crown Corporation, owned by the Province of Newfoundland and Labrador ("Province"). Hydro generates, transmits and distributes electrical power and energy to utility, industrial and residential customers throughout the Province.

Hydro is the parent company of the Hydro Group of Companies ("Hydro Group") comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co."), Lower Churchill Development Corporation Limited ("LCDC"), Gull Island Power Company Limited ("GIPCo."), and Twin Falls Power Corporation Limited ("TWINCo."). The Hydro Group's installed generating capacity is the fourth largest of all utility companies in Canada. Our power generating assets include nine operating hydraulic plants, including the Churchill Falls hydraulic plant, which is the largest underground power-house in the world with a rated capacity of 5,428 MW of power, one oil-fired plant, four gas turbines and 28 diesel plants.

FINANCIAL OVERVIEW

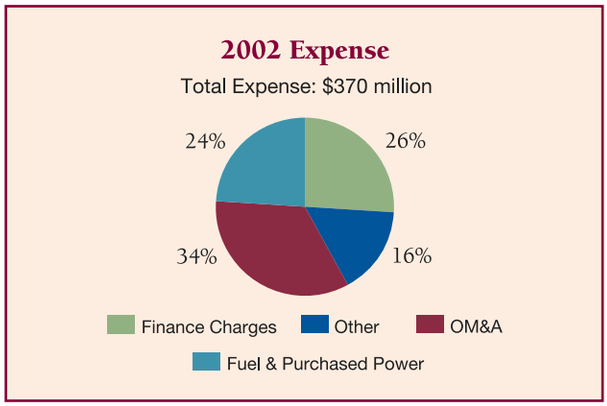
During 2002, Hydro continued to provide safe, reliable, cost-effective power to customers throughout the Province, export electricity to Hydro-Québec and pay significant dividends to the Province. Net income for 2002 increased by $4.0 million compared to 2001.

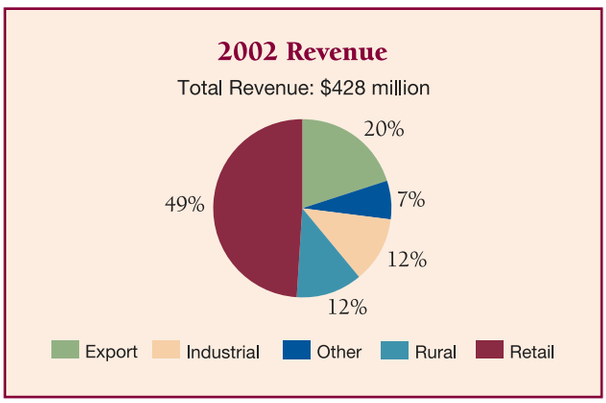
Income was up 7% mainly due to increased sales to all classes of customers in 2002, as well as an increase in base rates to most regulated customers effective September 1, 2002. At the same time, a large portion of the increase in revenue was offset by higher fuel costs and higher operations and administration expenses. Debt levels rose in 2002 to finance a portion of capital expenditures, as well as fuel costs which were deferred in the Rate Stabilization Plan ("RSP").

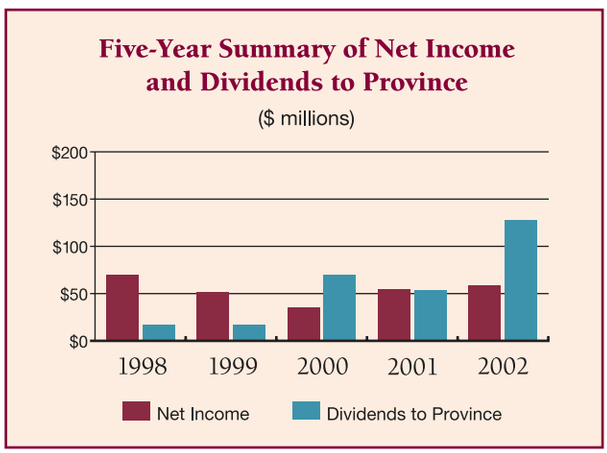
The Hydro Group has a workforce of approximately 1,220 Full-Time Equivalents.

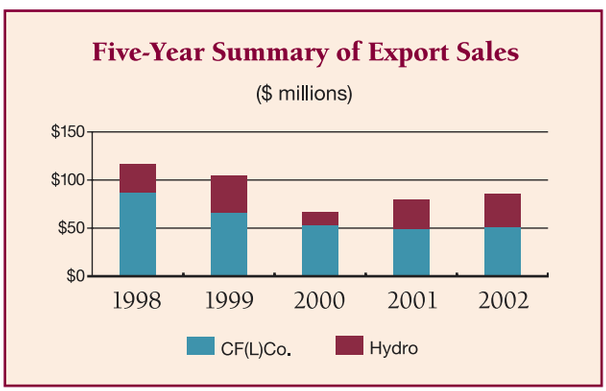
COMPOSITION OF REVENUE AND EXPENSE

Hydro's revenue consists of sales of electricity to several large industrial customers in the Province and over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Hydro also sells energy to Newfoundland Power, an investor-owned utility that distributes electrical power to









the balance of the population on the island portion of the Province. Export sales consist of power generated at Churchill Falls and sold to Hydro-Québec. The majority of these sales are made directly by CF(L)Co. to Hydro-Québec at rates set under a long-term power contract. The remainder is sold to Hydro-Québec by Hydro at market rates.

The Corporation's major expense categories consist of fuel and purchased power, operating, maintenance and administration, finance charges and depreciation.

NET INCOME

Hydro's consolidated net income was $58 million in 2002, an increase of $4.0 million from 2001. Over the past five years, Hydro has paid $285 million in dividends to the Province.

REVENUE

Total revenue growth in 2002 was approximately 8%, mainly due to load growth in both the retail and industrial sectors combined with a general rate increase to regulated customers approved by the PUB effective September 2002. Also contributing to higher revenue was higher export sales to Hydro-Québec and additional compensation from the Guaranteed Winter Availability Contract between CF(L)Co. and Hydro-Québec.

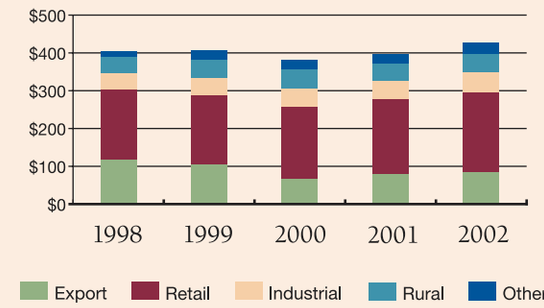
EXPENSES

Total expenses for 2002 were 8% higher than 2001, primarily due to a 46% increase, or $23 million, in fuel costs. This increase is due to higher fuel prices in base rates and an increase in thermal production due to higher energy sales, coupled with a decrease in hydraulic production relative to thermal. In 2002, 17¢ of every dollar of revenue went to pay for fuel costs compared to 13¢ in 2001.

Hydro pays various fees, taxes and other charges as indicated below:

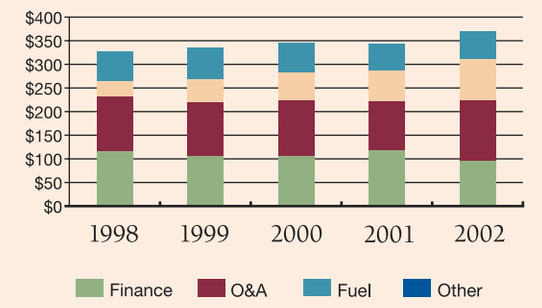
Five-Year Summary of Revenue

($ millions)

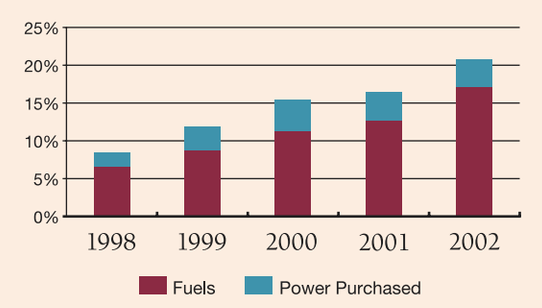


Five-Year Summary of Expense

($ millions)



Five-Year Summary of Fuel and Purchased Power Costs as a Percentage of Revenue



Fees, Taxes and Water Rentals (millions of dollars)

Payment	Recipient	**2002**	2001
Debt Guarantee Fee	Government of Newfoundland and Labrador	**$ 12.2**	$ 11.2
Payroll Tax	Government of Newfoundland and Labrador	**1.1**	1.1
Rentals and Royalties	Government of Newfoundland and Labrador	**4.4**	4.3
Municipal Taxes	Various Newfoundland and Labrador Municipalities	**1.0**	1.0
Total		**$ 18.7**	$ 17.6

OPERATIONS AND ADMINISTRATION

Operations and administration expense increased 6% in 2002 over 2001. This increase was due primarily to higher salaries and fringe benefits costs, plus significant maintenance expense relating to an overhaul of one of CF(L)Co.'s aircraft. Salaries were up in 2002 reflecting terms of collective bargaining agreements and an increase in the cost of benefits, as well as lower allocations to the capital program.

In 2002, 29¢ out of every dollar in revenue went to pay for operations and administration. This is down from 30¢ in 2001.

FINANCE CHARGES

Although overall borrowings increased, net interest expense, including the guarantee fee, decreased in 2002 by $4.7 million to $97.8 million. This is mainly due to lower interest rates on Hydro's debt and lower outstanding balance of CF(L)Co.'s debt.

CAPITAL EXPENDITURES

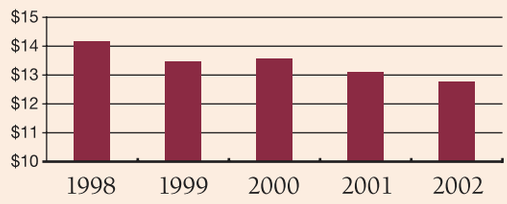
In order to ensure a safe, reliable and cost-effective supply of electricity for its customers, Hydro invested $110 million in various capital projects during 2002, compared to $95 million in 2001. Major capital investments in 2002 included:

- $63 million to add 40 MW of hydraulic generation capacity at Granite Canal situated within the existing Bay d'Espoir Development by June 2003.
- $6 million related to the potential development of hydro projects in Labrador.
- $13 million to strengthen transmission lines on the Avalon Peninsula.
- $6 million related to the improvements to our Distribution System, along with additions for new customers.
- $3 million for improvements to our Isolated Diesel plants which included $1.8 million for the completion of a new diesel plant at Nain.
- $4 million for the purchase of joint use poles from Aliant.
- $4 million for improvements at our Hydraulic Plant which included $1.3 million to interconnect one of our water control structures to the System Grid.

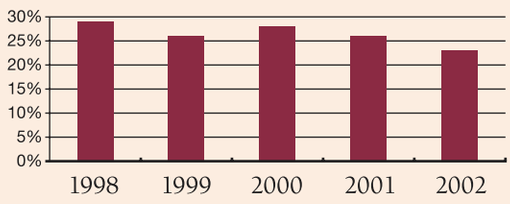
BORROWING AND DEBT

During 2002, Hydro was able to take advantage of a favourable interest rate environment and borrowed $250 million of long-term Canadian denominated debt. The Corporation also increased promissory notes outstanding by $44 million. Funds

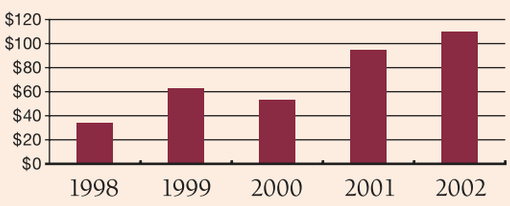
OM&A Per MWh



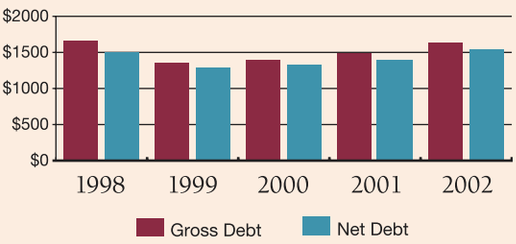
Five-Year Summary of Finance Charges as a Percentage of Revenue



Five-Year Summary of Capital Expenditures



Debt Outstanding at December 31



from these borrowings were used to finance a portion of the Corporation's capital expenditures, fund the refinancing of a $100 million maturing long-term debenture, retire $40 million in other long-term debt and make sinking fund contributions of $14 million.

Hydro's net debt increased $140 million to $1,538 million at December 31, 2002, from $1,398 million at December 31, 2001.

PERFORMANCE MEASURES

During 2001, Hydro developed a strategic plan to provide long-term direction and facilitate long-term planning. The plan includes Hydro's mandate, mission, vision statement and core values, as well as its strategic objectives. One of the stated objectives is: "To optimize corporate performance". During 2002, Hydro identified several key indicators of corporate performance while attempting to maintain consistency with measures used by the Canadian Electricity Association ("CEA") Committee on Corporate Performance and Productivity Evaluation ("COPE").

Return on equity increased from 2001, primarily due to a decrease in retained earnings caused by the payment of $121 million in dividends to the Province during 2002. This, coupled with increased borrowing required to fund the capital program and growing RSP balances, caused the percentage of debt in capital structure to increase during 2002 as well. OM&A cost per MWh improved during 2002 due to an increase in energy delivered without a commensurate increase in controllable costs.

SAIDI and SAIFI measures deteriorated during 2002, primarily due to equipment failures and adverse weather conditions, as well as an increase in planned outages to accommodate distribution system upgrading.

Financial Performance Indicators (Hydro only)	**2002**	2001
Return on Equity (%)	**15.9**	13.5
Debt to Capital (%)	**85.00**	79.00
Interest Coverage Ratio	**1.37**	1.38
OM&A Per MWh ($)	**12.77**	13.12

Non-Financial Performance Indicators (Hydro only)	**2002**	2001
SAIFI – Transmission	**1.72**	1.43
SAIDI – Transmission (minutes)	**106.72**	44.00
SAIFI – Distribution	**9.44**	7.47
SAIDI – Distribution (hours)	**13.63**	10.17
Generated Energy (GWh)	**39,421.00**	36,496.00
All Injury Frequency Rate	**1.98**	2.17
Customer Satisfaction Index	**8.1**	7.9

Description of Performance Indicators

Return on Equity – Net Income / Average Equity.

Debt to Capital – Year-end debt balance expressed as a percentage of the total corporate financing structure.

Interest Coverage Ratio – The extent to which income before financing charges is able to cover the Corporation's interest obligations.

System Average Interruption Frequency Index (SAIFI) – Total number of sustained outages/total number of delivery points or customers. An outage is sustained if over one minute in duration. For transmission, denominator is delivery points; for distribution, it is customers. This is used to track the overall performance of Hydro's transmission and distribution system.

System Average Interruption Duration Index (SAIDI) – Total duration (minutes) of all outages/number of delivery points or customers. For transmission, denominator is delivery points; for distribution, it is customers. This is used to track the performance in responding to outages.

Generated Energy (GWh) – is the volume of electricity that was generated from Hydro's generating facilities.

All Injury Frequency Rate – [(# of disabling injuries + # of medical aid injuries) x 200,000] / Hours worked. It measures the frequency with which injuries occur.

OM&A Per MWh – Controllable Corporate Operating, Maintenance and Administrative Cost / energy deliveries (MWh).

Customer Satisfaction Index – The weighted average of satisfaction ratings of the service attributes, based on annual rural residential customer survey.

HYDRO SUBSIDIARIES

Hydro has one wholly-owned subsidiary, GIPCo., as well as a 51% interest in LCDC and a 65.8% interest in CF(L)Co. CF(L)Co. is incorporated under the laws of Canada and operates a hydroelectric generating plant and related transmission facilities in Labrador with a rated capacity of 5,428 MW.

REGULATION

In September 2002, new rates were approved by the Board of Commissioners of Public Utilities ("PUB") for all of Hydro's regulated sales. The hearing into the general rate application, which was filed in May 2001, was the longest hearing in Hydro's history. The length of the hearing was due, at least in part, to the extended period of time since Hydro's previous general rate proceeding, approximately ten years earlier, as well as the changes in the regulatory framework since that time.

Prior to 1996, final approval of Hydro's retail rates rested with the Government, following recommendations made by the PUB after public hearings were held. However, as a result of legislative changes in 1996, the PUB has full authority in the Province to deal with regulatory matters concerning Hydro, including approval of its capital and borrowing programs, in addition to the rates charged to most of its customers. The hearing of 2001-2002 was Hydro's first proceeding as a utility regulated on the basis of return on rate base. During that hearing, Hydro proposed to seek a nominal rate of Return On Equity ("ROE") of 3% in the short term in order to lessen the impact of the increase in fuel price on rates. The PUB accepted this proposal and acknowledged that this level of ROE is below normal market returns.

Hydro will be filing a rate application in 2003 seeking to recover additional costs of new power purchase contracts with non-utility generators, as well as costs of a new hydro development, Granite Canal, which is coming on-stream in mid-2003. There are also other matters to pursue which were initiated at the previous hearing including corporate financial targets, rural rate setting, the rural deficit and fuel costs. Hydro will be seeking resolution of these matters in 2003.

2002 NET INCOME

(millions of dollars)

2002 Net Income	Hydro (Unconsolidated)	CF(L)Co.	GIPCo.	LCDC	Eliminating Entries	Hydro (Consolidated)
Revenue	$ 362.2	$ 66.8	$ -	$ -	$ (1.3)	$ 427.6
Expenses	321.4	48.8	-	-	(0.5)	369.7
Net Income (loss)	$ 40.8	$ 18.0	$ -	$ -	$ (0.8)	$ 57.9

2002 BALANCE SHEET

Total Assets	$ 2,044.8	$ 406.9	$ 100.0	$ 30.2	$ (262.6)	$ 2,319.3
Liabilities	$ 1,551.2	$ 163.9	$ -	$ -	$ 10.6	$ 1,725.7
Equity	493.6	243.0	100.0	30.2	(273.2)	593.6
Total Liabilities and Equity	$ 2,044.8	$ 406.9	$ 100.0	$ 30.2	$ (262.6)	$ 2,319.3

OUTLOOK FOR 2003

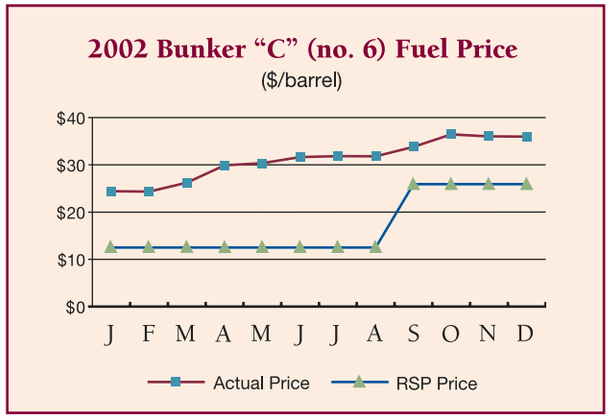
Earnings are expected to be lower in 2003, primarily due to increased fuel and power purchase costs, as well as higher interest expense. Additionally, the total outstanding balances owing to Hydro from customers related to deferred fuel charges in the RSP is forecast to exceed $160 million by year-end 2003.

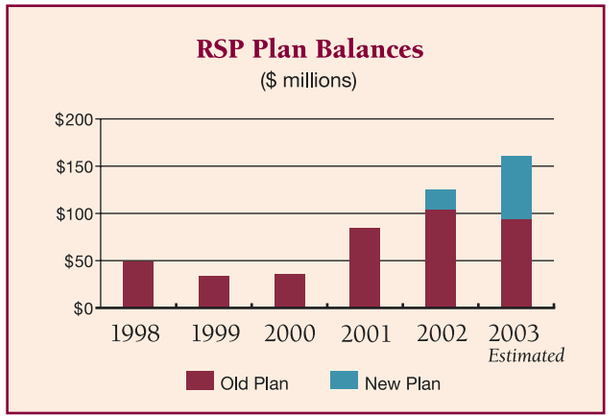
RATE STABILIZATION PLAN

In addition to the impact that the change in fuel price and lower reservoir levels have had on Hydro's income statement, there have also been significant impacts on the balance of the RSP. Prior to September 2002, the price of no. 6 fuel in the base rates to be charged to consumers was $12.50 per barrel. As fuel prices increased, the difference between the cost of fuel consumed and the cost upon which rates were set, accumulated in the RSP resulting in a balance owing to Hydro from its customers of $105.8 million at the end of August 2002. As a result of the 2001-2002 general rate application before the PUB, this balance was frozen and is to be recovered over a five-year period. Additionally, the price of no. 6 fuel was reset to $25.91 per barrel, which was the average forecast price for 2002 at that time. However, during 2002, purchase prices peaked at $39.43 per barrel in September which resulted in the average price per barrel consumed climbing to $36 by year-end. As at December 31, 2002, an additional amount of $20.5 million owing to Hydro from its customers had accumulated in the RSP. This amount, plus amounts accumulating through 2003, will be recoverable over a two-year period starting in 2004. Based on a current average forecast fuel price of $32.70 per barrel, Hydro is projecting this balance to grow to $67 million by year-end 2003.

HUMAN RESOURCES

Human resource management including recruitment and retention of a qualified workforce, compensation, training and development and succession planning will remain key to Hydro's continued success as 25% of its workforce will be eligible for retirement over the next five years. Fostering cooperative relations with Hydro's bargaining units is also key for future success. In 2002, collective agreements were renewed with the IBEW for a three-year period.





INFRASTRUCTURE AND TECHNOLOGY

Hydro's generation and transmission facilities were constructed primarily during the 1960's and 1970's. Many facilities are now approaching 40 years of age and require increasing amounts of maintenance to maintain acceptable levels of reliability. Significant capital investment is also required each year to ensure that facilities and equipment are upgraded, replaced or installed to meet the increasing demand for electrical energy from our customers.

New developments in generation, transmission and distribution, and metering technologies will affect the way the Corporation operates in the future. Renewable energy sources, such as wind, may offer the potential for cost-effective generation of power.

ENVIRONMENT

Environmental issues are expected to become more significant for the utility industry in the future. In an effort to continue to provide reliable service while realizing its responsibility to the environment, Hydro adopted the ISO 14001 Environmental Management System ("EMS") standard in 1997. ISO 14001 is the foundation of the CEA's Environmental Commitment and Responsibility Program. It requires organizations to make a commitment to comply with legal and other requirements, prevent pollution and work to continually improve their environmental performance.

RISK MANAGEMENT

Hydro is exposed to various forms of risk in its business environment. Changes in interest rates, fluctuation in foreign currency exchange rates and changes in fuel prices can impact an organization's future financial success.

The Corporation manages its exposure to interest rates through an ongoing benchmarking against key indices, having due consideration for the Corporation's relative risk profile. This approach was instrumental in the Corporation's decision in 2002, to increase floating rate debt as a percentage of overall debt, and thereby take advantage of historically low short-term rates in that year. The Corporation mitigates its foreign exchange exposure through a diversified approach utilizing forward currency contracts.

The Corporation is also subject to risks associated with damage of its assets, interruption of service and liability claims. The Hydro Group recognizes these exposures and employs a variety of risk control and financing techniques. Regular maintenance and inspection of assets, redundancy of critical facilities and other loss prevention solutions are utilized to eliminate and/or reduce these exposures. The Corporation purchases an insurance program to finance certain potential losses. This program is reviewed at least annually to ensure the appropriate coverages are purchased at the most reasonable cost. Self-insurance, insurance deductibles and reviews of exposures are also used to reduce the cost of risk.

As an electrical utility, the working environment for the majority of Hydro's employees is hazardous and unforgiving. To ensure that its employees are protected from accidents and industrial illness, Hydro has established a comprehensive Safety and Health Program. The program draws on industry best practices, state-of-the-art personal protective equipment, task analysis and standardized work methods and engineered solutions to provide employees with a safe environment in which to work. The safety and well being of its workforce is a priority at Hydro.

IMPROVING BUSINESS PROCESS

In 2002, Hydro implemented a business improvement process to ensure continuous improvement in work processes driven by process metrics and traceable to corporate Key Performance Indicators ("KPI"). This is consistent with our strategic planning process and the resulting strategic issues and goals.

A senior management improvement team, headed by an executive director and assisted initially by a consultant, through various process improvement teams, reviewed and renewed the goods and services process, the inventory and consumables process, the purchasing card and travel process and the accounts payable process. In addition to these processes, the teams started the review and renewal of the work management and budgeting process and the asset management process.

Hydro's objective is to eliminate non-value added work in its processes and leverage the functionality of its integrated software suite to support process improvement and deliver better business information, effective work management tools, effective budgeting tools and process metrics.

MANAGEMENT REPORT

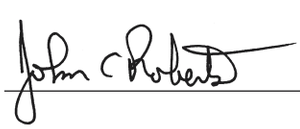
The accompanying consolidated financial statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 14, 2003. Financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditors, Ernst & Young LLP, is to express an independent, professional opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfils its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with Management, the internal auditors and the external auditors to satisfy itself that each group has properly discharged its respective responsibility and to review the financial statements before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.



John C. Roberts
Vice-President, Finance and Chief Financial Officer

William E. Wells
President and Chief Executive Officer

AUDITORS' REPORT

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2002, and the consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2002, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

St. John's, Newfoundland and Labrador
Canada
February 14, 2003

Ernst & Young LLP
Chartered Accountants

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2002**	2001
		(Note 2)
ASSETS		
Capital assets (Note 3)		
Capital assets in service	**2,604.7**	2,566.8
Less contributions in aid of construction	**108.9**	109.9
	2,495.8	2,456.9
Less accumulated depreciation	**745.7**	707.6
	1,750.1	1,749.3
Construction in progress	**154.6**	88.7
	1,904.7	1,838.0
Current assets		
Cash and cash equivalents	**0.2**	1.1
Short-term investments	**-**	4.0
Accounts receivable	**62.0**	56.4
Current portion of rate stabilization plan	**-**	21.1
Current portion of long-term receivable (Note 4)	**27.5**	10.3
Fuel and supplies at average cost	**48.0**	46.3
Prepaid expenses	**2.5**	2.0
	140.2	141.2
Long-term receivables (Note 4)	**110.6**	33.1
Sinking funds (Note 10)	**48.7**	42.7
Investments (Note 5)	**5.2**	5.2
Rate stabilization plan	**20.5**	63.9
Deferred charges (Note 7)	**89.4**	100.1
	2,319.3	2,224.2

See accompanying notes

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2002**	2001
		(Note 2)
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 8)	**1,354.9**	1,156.7
Current liabilities		
Bank indebtedness	**4.4**	2.1
Short-term borrowing	**3.3**	-
Accounts payable and accrued liabilities	**59.3**	48.7
Accrued interest	**27.7**	25.5
Long-term debt due within one year (Note 8)	**50.2**	146.3
Promissory notes (Note 8)	**181.5**	138.0
	326.4	360.6
Employee future benefits (Note 9)	**29.6**	28.5
Non-controlling interest in LCDC	**14.8**	14.8
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Note 5)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**100.0**	100.0
Retained earnings	**453.5**	523.5
	593.6	663.6
Commitments and contingencies (Note 12)	**-**	-
	2,319.3	2,224.2

See accompanying notes

On behalf of the Board:

Director

Director

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2002**	2001
		(Note 2)
Revenue		
Energy sales	**399.6**	374.8
Recovery of costs in rate stabilization plan	**14.0**	11.2
Guaranteed winter availability	**9.5**	7.5
Rentals and royalties	**0.3**	0.3
Other	**4.2**	3.3
	427.6	397.1
Expenses		
Operations and administration	**125.8**	119.1
Fuels	**73.2**	50.2
Amortization of costs in rate stabilization plan	**14.0**	11.2
Power purchased	**15.8**	15.6
Depreciation	**43.0**	44.5
Interest (Note 11)	**97.8**	102.5
	369.6	343.1
Net income	**58.0**	54.0
Retained earnings, beginning of year, as previously reported	**528.6**	528.5
Less CF(L)Co. foreign exchange loss (Note 2)	**5.1**	5.7
Retained earnings, as restated	**523.5**	522.8
Dividends	**128.0**	53.3
Retained earnings, end of year	**453.5**	523.5

See accompanying notes

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2002**	2001
		(Note 2)
Cash provided by (used in)		
Operating activities		
Income before non-controlling interest	**58.0**	54.0
Adjusted for items not involving a cash flow		
Depreciation	**43.0**	44.5
Amortization of deferred charges	**4.0**	1.6
Rate stabilization plan	**64.5**	(49.4)
Other	**-**	3.8
Foreign exchange (gain) loss	**(0.1)**	0.5
	169.4	55.0
Change in non-cash balances related to operations		
Accounts receivable	**(5.6)**	(2.3)
Fuel and supplies	**(1.7)**	2.7
Prepaid expenses	**(0.5)**	0.5
Accounts payable and accrued liabilities	**11.8**	6.2
Accrued interest	**2.2**	(1.2)
Employee future benefits	**1.1**	1.4
Long-term receivable	**(104.8)**	2.6
	71.9	64.9
Financing activities		
Long-term debt issued	**250.0**	250.0
Long-term debt retired	**(138.1)**	(185.9)
Foreign exchange loss recovered	**8.5**	7.8
Increase in short-term borrowing	**3.3**	-
Increase in promissory notes	**43.5**	17.2
Dividends	**(128.0)**	(53.3)
	39.2	35.8
Investing activities		
Net additions to capital assets	**(109.7)**	(94.9)
Decrease in short-term investments	**4.0**	0.1
Increase in sinking funds	**(14.1)**	(11.5)
Decrease in investments	**-**	4.1
Reductions (additions) to deferred charges	**6.7**	(2.0)
Change in accounts payable related to investing activities	**(1.2)**	7.4
	(114.3)	(96.8)
Net (decrease) increase in cash	**(3.2)**	3.9
Cash position, beginning of year	**(1.0)**	(4.9)
Cash position, end of year	**(4.2)**	(1.0)
Cash position is represented by		
Cash and cash equivalents	**0.2**	1.1
Bank indebtedness	**(4.4)**	(2.1)
	(4.2)	(1.0)
Supplementary disclosure of cash flow information		
Interest income received	**1.7**	2.3
Interest paid	**104.1**	106.6

See accompanying notes

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador ("Province") as a Crown Corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly-controlled companies, other than Twin Falls Power Corporation Limited ("TWINCo."), are exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and to conform with recommendations of the Board of Commissioners of Public Utilities ("PUB") of the Province.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are regulated on the basis of return on rate base. As well, Hydro's borrowing and capital expenditure programs are subject to review and approval by the PUB.

Rates charged to rural customers do not recover the full costs of providing the service, but Hydro recovers the resulting deficit from other customers.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited ("GIPCo."), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co.") and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. subsequent to the effective date of the shareholders' agreement.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,500 kilowatts ("CF(L)Co. Project"). A power contract with Hydro-Québec dated May 12, 1969, ("Power Contract") provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. CF(L)Co. receives certain benefits from Hydro-Québec, including significant revenues, under a Guaranteed Winter Availability Contract through 2041.

The cost of Hydro's investment in CF(L)Co. exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2002, $32.4 million (2001 - $31.2 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo. is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland ("Gull Island Project"), (Note 5).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River ("Lower Churchill Development"), (Note 5).

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents, whereas those with original maturities beyond three months and less than

12 months are classified as short-term investments. Both are stated at cost, which approximates market value. There were no investments outstanding at December 31, 2002. There were short-term investments outstanding at December 31, 2001, bearing interest rates of 2.20% to 6.09% per annum.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo. and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro has made no provision in its accounts to date for future removal and site restoration costs. The inclusion of these costs in the rate base is subject to the rate setting process.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co.

CF(L)Co. uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

CF(L)Co. has made no provision in its accounts for future removal and site restoration costs as they cannot be estimated at this time.

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan ("RSP") which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan do not require a reference to the PUB and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

In 2002, the PUB ordered changes with respect to the recovery of the balance in the RSP, as well as for any future balances that may accumulate. The RSP balance as at August 31, 2002, has been converted to a long-term receivable and the balance outstanding at December 31, 2002, will be recovered over five years, commencing in 2003 (Note 4). The RSP activity for the period September - December 2002, and all of 2003, will be amortized over two years, commencing in 2004.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Promissory Notes

Promissory Notes bear interest from 2.80% to 3.29% per annum (2001 - 2.15% to 3.90%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2001 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date.

(i) In the case of Hydro, foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. This amortization is included in interest expense. Commencing in 2002, the PUB ordered Hydro's deferred foreign exchange losses, net of the $10.0 million provision previously accumulated, be amortized over a forty-year period (Note 7).

(ii) Under the provisions of the Power Contract, CF(L)Co.'s exposure for a foreign exchange loss is limited. CF(L)Co. recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss, which is recoverable on the settlement dates, is included in long-term receivables (Note 4).

Financial Instruments

Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

2. ACCOUNTING CHANGE

Foreign Exchange

Churchill Falls has adopted new recommendations of the Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses. Unrealized gains and losses associated with the First Mortgage Bonds that are not recoverable from Hydro-Québec under the Power Contract are included in net income for the current year. Previously, these gains and losses were deferred and amortized on a straight-line basis over the remaining life of the debt. This change has been applied retroactively, and prior years have been restated to reflect this change. Accordingly, the impact on the 2002 financial statements is an increase in net income of $1.2 million, and the impact on the 2001 financial statements is a reduction in opening retained earnings of $5.7 million and an increase in net income of $0.6 million.

3. CAPITAL ASSETS

millions of dollars	Capital Assets in Service	Contributions in Aid of Construction	Accumulated Depreciation	Construction in Progress
		2002		
Generation Plant				
Hydroelectric	**1,243.6**	**20.5**	**256.1**	**102.7**
Thermal	**223.5**	**-**	**173.3**	**0.2**
Diesel	**62.5**	**7.9**	**23.1**	**0.1**
Transmission and Distribution	**693.3**	**56.0**	**155.7**	**1.0**
Service facilities	**22.0**	**-**	**9.5**	**-**
Project costs (Note 5)	**96.4**	**-**	**-**	**-**
Capital studies (Note 5)	**25.0**	**-**	**-**	**-**
Other	**238.4**	**24.5**	**128.0**	**50.6**
	2,604.7	**108.9**	**745.7**	**154.6**

millions of dollars		2001		
Generation Plant				
Hydroelectric	1,240.1	20.5	245.2	40.0
Thermal	225.8	-	173.4	-
Diesel	58.7	8.3	21.7	3.3
Transmission and Distribution	666.2	56.7	140.8	1.5
Service facilities	22.0	-	9.1	-
Project costs (Note 5)	96.5	-	-	-
Capital studies (Note 5)	25.0	-	-	-
Other	232.5	24.4	117.4	43.9
	2,566.8	109.9	707.6	88.7

Included in the above amounts are CF(L)Co. assets in service amounting to $633.6 million (2001 - $631.3 million) which are pledged as collateral for long-term debt.

4. LONG-TERM RECEIVABLES

millions of dollars	**2002**	2001
Previous Rate Stabilization Plan		
Retail	**76.3**	-
Industrial	**28.0**	-
	104.3	-
Hydro-Québec		
Unrealized foreign exchange	**31.1**	41.2
Other	**2.7**	2.2
	33.8	43.4
Less due within one year	**27.5**	10.3
	110.6	33.1

The receivable arising from the RSP bears interest at the weighted average cost of capital, which is approximately 7.2%, and is to be recovered over a five-year period commencing in 2003.

The other long-term receivable from Hydro-Québec bears interest at 7% per annum and is receivable over a four-year period which commenced in September 2000.

5. INVESTMENTS

millions of dollars	**2002**	2001
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement ("Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, ("Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, ("Option Agreement"). The purchase price in respect of GIPCo.'s assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2003, and it is not anticipated that there will be any loss upon sale of GIPCo.'s assets to LCDC.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. In 1979, 520 shares were acquired pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

6. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2002, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2002.

millions of dollars	**2002**	2001
Current assets	**34.6**	34.9
Long-term assets	**371.7**	389.9
Current liabilities	**45.3**	40.2
Long-term liabilities	**113.9**	148.8
Revenues	**62.9**	58.6
Expenses	**49.0**	47.9
Net income	**13.9**	10.7
Cash provided by (used in)		
Operating activities	**25.4**	28.9
Financing activities	**(24.3)**	(25.0)
Investing activities	**1.6**	1.2

7. DEFERRED CHARGES

millions of dollars	**2002**	2001
Debt discount, financing expenses and other	**19.6**	26.2
Accumulated amortization	**14.3**	12.4
	5.3	13.8
Foreign exchange losses realized	**96.3**	96.3
Accumulated provision	**10.0**	10.0
	86.3	86.3
Accumulated amortization	**2.2**	-
	84.1	86.3
Net deferred charges	**89.4**	100.1

8. LONG-TERM DEBT

	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
millions of dollars		**2002**			2001	
Summary of long-term debt						
Long-term debt	**1,257.1**	**148.0**	**1,405.1**	1,122.3	180.7	1,303.0
Less payments due within one year	**16.1**	**34.1**	**50.2**	114.4	31.9	146.3
	1,241.0	**113.9**	**1,354.9**	1,007.9	148.8	1,156.7

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2003	2004	2005	2006	2007
	50.2	32.8	31.0	230.1	30.1

The payments due within one year include sinking fund requirements of $8.8 million (2001 - $7.3 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2002**	2001	
Z	5.25	1997	2002	**-**	100.0	
AC	5.05	2001	2006	**200.0**	100.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	150.0	(a)
Total debentures				**1,275.0**	1,125.0	
Less sinking fund investments in own debentures				**46.0**	37.9	
				1,229.0	1,087.1	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**25.1**	31.0	
Other				**3.0**	4.2	
				1,257.1	1,122.3	
Less payments due within one year				**16.1**	114.4	
				1,241.0	1,007.9	

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co.

millions of dollars	**2002**	2001
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $63.4; 2001 - U.S. $81.8)	**100.2**	130.2
7.875% Series B due December 15, 2007	**6.4**	8.3
General Mortgage Bonds		
7.500% due December 15, 2010	**41.4**	42.2
	148.0	180.7
Less payments due within one year	**34.1**	31.9
	113.9	148.8

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There has been no contingent repayments in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however, fixed sinking fund payments are estimated to average $22.4 million in each of the years 2003 to 2007 inclusive.

Under the terms of long-term debt instruments, CF(L)Co. may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999 places additional restrictions on dividends based on cash flow.

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of $3.6 million (2001 - $3.4 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. Information about these plans is as follows:

millions of dollars	**2002**	2001
Accrued benefit obligation		
Balance at beginning of year	**28.5**	27.1
Current service cost	**0.9**	0.9
Interest cost	**2.0**	2.0
Actuarial loss	**7.5**	-
Past service cost	**0.4**	-
Benefits paid	**(1.8)**	(1.5)
Balance at end of year	**37.5**	28.5
Plan deficit	**37.5**	28.5
Unamortized actuarial loss	**(7.5)**	-
Unamortized past service cost	**(0.4)**	-
Accrued benefit liability at end of year	**29.6**	28.5

The most recent actuarial valuation was performed as at December 31, 2002. The significant actuarial assumptions used in measuring the company's accrued benefit obligations include a discount rate of 7.0% and an average rate of compensation increase of 3.5%. In addition, in determining the expected cost of health care benefits, it was assumed that health care costs will increase by 12.0% in 2003, decrease gradually to 5.0% in 2010 and remain level thereafter.

The net benefit plan expense is as follows:

millions of dollars	**2002**	2001
Current service cost	**0.9**	0.9
Interest cost	**2.0**	2.0
Net benefit plan expense	**2.9**	2.9

10. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2002, and 2001, are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
millions of dollars		**2002**		2001
Financial Assets				
Sinking funds	**48.7**	**54.2**	42.7	43.5
Long-term receivable including amount due in one year	**138.1**	**138.2**	43.4	43.5
Financial Liabilities				
Long-term debt including amount due in one year	**1,405.1**	**1,673.6**	1,303.0	1,489.9

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and, as such, their carrying value approximates fair value. At December 31, 2002, of the total accounts receivable balance outstanding, approximately 46.9% (2001 - 45.6%) is due from a regulated utility and 25.1% (2001 - 28.0%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2028. Hydro debentures, which Management intends to hold to maturity, are deducted from long-term debt, while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 5.80% to 10.55% (2001 - 5.80% to 10.55%).

11. INTEREST EXPENSE

millions of dollars	**2002**	2001	
Gross interest			
Long-term debt	**105.3**	105.6	
Promissory notes	**5.0**	6.2	
	110.3	111.8	
Amortization of debt discount and financing expenses	**1.3**	1.3	
Provision for foreign exchange losses	**2.2**	1.0	
Foreign exchange (gain) loss	**(0.1)**	0.5	
	113.7	114.6	
Less			
Recovered from Hydro-Québec	**5.3**	6.3	(a)
Interest capitalized during construction	**7.7**	5.1	
Interest earned	**15.1**	11.8	
Net interest expense	**85.6**	91.4	
Debt guarantee fee	**12.2**	11.1	
Net interest and guarantee fee	**97.8**	102.5	

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

12. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co. is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements, is approximately $6.4 million (2001 - $1.6 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $23.0 million related to outages and plant shutdowns. Hydro is defending this claim, and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $23.8 million at December 31, 2002, (2001 - $80.9 million). Hydro has commenced development of a hydroelectric generating station at Granite Canal. The total project cost is expected to be approximately $134.6 million, with an anticipated in-service date of June 2003. As at December 31, 2002, $102.7 million (2001 - $40.0 million) had been expended on this project.

(d) In connection with the Granite Canal development, Hydro has issued an irrevocable Letter of Credit, in the amount of $5.4 million, to ensure compliance with the terms of the Fish Habitat Compensation Agreement between Hydro and the Department of Fisheries and Oceans.

13. COMPARATIVE FIGURES

Certain of the 2001 comparative figures have been reclassified to conform with the 2002 financial statement presentation.

FINANCIAL STATISTICS

Years ended December 31 (millions of dollars)	**2002**	2001 [2]	2000	1999 [1]	1998
OPERATING RESULTS					
Revenue					
Energy sales	**399.6**	374.8	357.0	384.4	391.8
Rentals and royalties	**0.3**	0.3	0.3	0.4	0.5
Recovery of costs in RSP	**14.0**	11.2	13.9	15.4	10.9
Guaranteed winter availability	**9.5**	7.5	4.6	3.6	-
Other	**4.2**	3.3	3.9	2.4	1.6
	427.6	397.1	379.7	406.2	404.8
Expenses					
Operations and administration	**125.8**	119.1	119.4	112.3	114.1
Amortization of RSP costs	**14.0**	11.2	13.9	15.4	10.9
Fuels and power purchased	**89.0**	65.8	58.3	48.2	34.0
Depreciation	**43.0**	44.5	47.7	51.3	50.5
Interest	**97.8**	102.5	105.5	107.6	117.8
	369.6	343.1	344.8	334.8	327.3
Income from operations	**58.0**	54.0	34.9	71.4	77.5
Write down of capital assets	**-**	-	-	16.7	-
Net income before non-controlling interest	**58.0**	54.0	34.9	54.7	77.5
Non-controlling interest	**-**	-	-	3.1	7.9
Net income	**58.0**	54.0	34.9	51.6	69.6
Contributions to net income					
Hydro Corporate	**40.9**	40.4	17.4	31.7	51.2
CF(L)Co.	**17.1**	13.6	17.5	19.9	18.4
FINANCIAL POSITION					
Total current assets	**140.2**	141.2	129.7	137.8	164.0
Total current liabilities	**326.4**	360.6	378.8	163.1	294.4
Net working capital	**(186.2)**	(219.4)	(249.1)	(25.3)	(130.4)
Capital assets	**2,650.4**	2,545.6	2,459.5	2,414.9	2,710.0
Accumulated depreciation	**745.7**	707.6	669.6	628.6	719.3
Capital assets, net	**1,904.7**	1,838.0	1,789.9	1,786.3	1,990.7
Sinking funds	**48.7**	42.7	35.4	28.8	113.3
Other assets	**225.7**	202.3	186.6	188.1	255.1
Long-term debt	**1,354.9**	1,156.7	1,043.3	1,226.4	1,398.5
Other liabilities	**44.4**	43.3	50.9	25.3	138.6
Shareholder's equity	**593.6**	663.6	668.6	726.2	691.6
EMPLOYEES AT YEAR END					
Permanent	**990**	1,026	1,063	1,069	1,078
Temporary	**241**	203	219	207	196
Total	**1,231**	1,229	1,282	1,276	1,274

(1) Effective June 18, 1999, Hydro adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. (65.8%).

(2) Restated to reflect Churchill Falls' adoption of new recommendations of the Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses.

OPERATING STATISTICS

Years ended December 31	**2002**	2001	2000	1999	1998
INSTALLED GENERATING CAPACITY (rated MW)					
CF(L)Co.	**5,428**	5,428	5,428	5,428	5,428
TWINCo.	**225**	225	225	225	225
Hydro					
Hydraulic	**899**	899	899	899	899
Thermal	**645**	645	645	645	645
Diesel	**57**	58	58	58	58
Total	**7,254**	7,255	7,255	7,255	7,255
ELECTRIC ENERGY GENERATED, NET (GWh)					
CF(L)Co.	**35,516**	32,910	35,108	34,508	37,543
Hydro					
Hydraulic	**3,986**	3,959	5,016	4,801	4,260
Thermal	**2,380**	2,095	966	914	1,255
Diesel	**48**	46	43	41	41
Total	**41,930**	39,010	41,134	40,264	43,099
ELECTRIC ENERGY SALES (GWh)					
CF(L)Co.					
Export	**30,782**	28,159	30,268	29,674	32,793
Hydro					
Utility	**4,589**	4,423	4,263	4,084	4,157
Rural	**894**	832	842	830	811
Industrial	**1,675**	1,528	1,607	1,343	1,286
Export	**1,481**	1,558	1,494	1,731	1,344
Total	**39,421**	36,500	38,474	37,662	40,391
AVERAGE RATE (cents per kWh)					
CF(L)Co.					
Export	**0.25**	0.27	0.27	0.27	0.27
Hydro					
Utility	**4.60**	4.50	4.49	4.49	4.49
Rural	**5.59**	5.60	5.53	5.54	5.46
Industrial	**3.08**	3.14	2.85	3.58	3.26
Export	**2.27**	2.22	2.22	2.22	2.22
TRANSMISSION LINES (km)					
CF(L)Co.					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,533**	1,534	1,536	1,536	1,536
138 kV	**1,533**	1,533	1,533	1,533	1,533
69 kV	**586**	587	586	586	586
Total	**4,691**	4,693	4,694	4,694	4,694
PEAK DEMAND (MW)					
CF(L)Co. System	**5,587**	5,637	5,606	5,590	5,602
Hydro System	**1,403**	1,262	1,240	1,265	1,295

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Deputy Minister
Mines and Energy

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Professional Engineer
(Retired)

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Dean T. MacDonald [1]
William E. Wells
James R. Haynes
David W. Reeves
Derek W. Osmond [2]

(1) Resigned November 25, 2002
(2) Retired December 31, 2002

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Assistant Corporate Secretary

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(2) Retired December 31, 2002

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HYDRO
THE POWER OF
COMMITMENT

Energy. Generated for you.

Newfoundland and Labrador Hydro

2003 Annual Report

HYDRO
THE POWER OF COMMITMENT

2003 Annual Report

MISSION

Newfoundland and Labrador 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.

Our skilled and committed employees will use innovative methods and technologies, and will maintain high standards of safety and health, and environmental responsibility.

VISION

To be recognized as an innovative provider of quality energy services.

VALUES

The fundamental truths and principles practiced by Hydro and its employees in providing quality service to all its customers and stakeholders:

Integrity – Trust, respect, honesty and fairness are essential in our daily interactions with all individuals and stakeholders.

Responsibility – We value actions that are ethically, environmentally and socially responsible.

Teamwork – We promote safety and health, cooperation and openness in a supportive work environment.

Competence – We encourage and support innovation, continual improvement and learning, and the sharing of our knowledge and experiences.

Accountability – We accept responsibility for our individual and collective actions and performance.

Positive Attitude – We value enthusiasm and pride in our work.

Table of Contents

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This paper contains 50% recycled content including 15% post consumer waste. It is acid free and chlorine free.

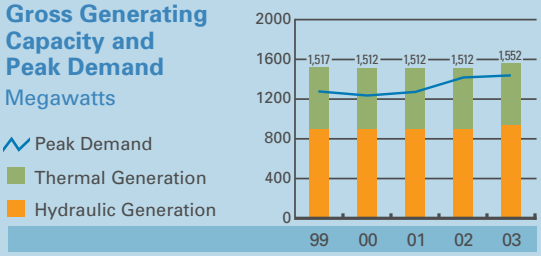
Hydro generates and transmits over
80 per cent of the province's electrical energy
through a reliable and cost-effective system.

We shed light on thousands
of bedtime stories every night.

Highlights

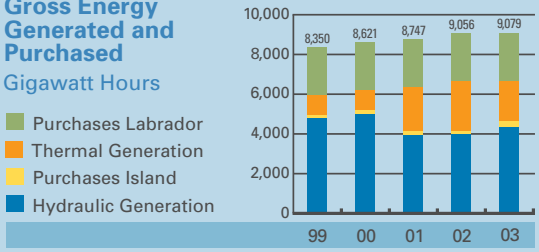
Island Interconnected Systems Gross Generating Capacity and Peak Demand

Megawatts



Interconnected Systems Gross Energy Generated and Purchased

Gigawatt Hours



From the President

Last summer North America watched as a blackout rolled through the eastern seaboard and central Canada crippling business and transportation, causing tremendous financial and economic impact. As a result, there has been considerable scrutiny of electrical systems throughout North America and a heightened awareness of the vulnerabilities present in any electrical system. In Newfoundland and Labrador we are isolated from the North American grid. It did lead us, however, to examine our systems and their inherent strengths and limitations.

BALANCING COSTS AND RELIABILITY

The cost of electricity and the reliability of supply are two of the most important issues for electrical consumers. Newfoundland and Labrador Hydro ("Hydro"), like all electrical utilities, is constantly challenged to find the appropriate balance between these competing interests. While there are unique issues facing the differing systems we operate and maintain, the governing factors of cost and reliability are constant.

Capital investments and operational improvements are always strategically directed at improving reliability. While we have statistical improvements in our distribution systems' performance, there are issues that we intend to address to ensure an improvement in the quality and reliability of electricity, particularly on the Great Northern Peninsula and in coastal Labrador communities.

FOCUSING ON CUSTOMERS

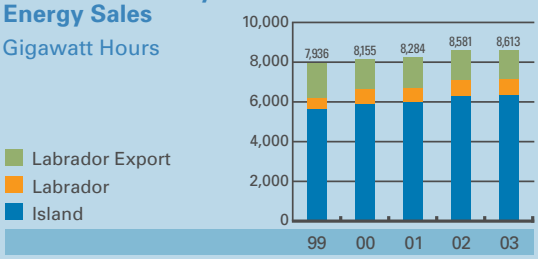
Our customers – industrial, utility, commercial and residential – are key stakeholders in our business. As part of our strategic planning, we are focused on meeting their expectations and building better relationships with all our valued customers. Essential to those relationships is the building of trust, and confidence that Hydro is meeting their requirements in a cost-effective and efficient manner. It is also important that we have a shared understanding of the system limitations and the challenges that must be overcome in the future.

POSITIVE FINANCIAL RESULTS

Financial results for Hydro in 2003 were better than anticipated. Despite a loss of $2.6 million in our regulated activity, Hydro's net income for 2003 was $44 million, before the write-down of unusual items as outlined in the financial statements and Management's

Interconnected Systems Energy Sales

Gigawatt Hours



"The cost of electricity and the reliability of supply are two of the most important issues for electrical consumers. Hydro, like all electrical utilities, is constantly challenged to find the appropriate balance between these competing interests."
– William Wells

Discussion and Analysis. The implementation of new rates approved by the Board of Commissioners of Public Utilities ("PUB") effective September 1, 2002, did not reflect the additional costs for new sources of generation required to meet system requirements that were incurred in 2003. Additional power purchases of $10.3 million and costs of the Granite Canal Hydroelectric Generating Station were absorbed by Hydro and will continue to be absorbed until the PUB approves new rates in mid-2004 to allow those costs to be incorporated into rates.

COMPETITIVE RATES MAINTAINED AS NEW SOURCES OF GENERATION BROUGHT ON STREAM

Two rate hearings in the span of two years has been a major challenge for Hydro. Following 10 years of no rate increases, we have had to deal with many issues before the PUB including volatile fuel prices and the cost of new sources of generation to meet system requirements. From our customers' perspective, it has meant significant increases in rates.

Despite the proposed increases, rates will remain competitive with other Atlantic Provinces. Looking forward, there are no increases forecast in capacity and energy on the Island Interconnected System until 2010. With fuel costs in rates more reflective of market price, we expect that our customers will see reasonable rate stability for the remainder of the decade.

President and CEO William E. Wells

From the President

A COMMITMENT TO THE ENVIRONMENT

The Hydro Group has made great strides in achieving its environmental objectives. At the end of this year, Hydro's Transmission and Rural Operations achieved all the requirements for ISO 14001 certification, completing the Hydro Group's objectives for corporate certification. The new Fish Habitat Compensation Facility, constructed in conjunction with the development at Granite Canal has set the benchmark for such projects across the country. A Continuous Emissions Monitoring System has been installed at the Holyrood Thermal Plant to assist in environmental monitoring and unit efficiency. The plant hosted over 200 members of the public to its fifth annual Open House during Environment Week. More details of our environmental achievements will be released in June 2004 in our fourth annual Environmental Performance Report.

POSITIVE PERFORMANCE AT CHURCHILL FALLS

Churchill Falls (Labrador) Corporation's ("CF(L)Co.") financial situation continues to improve as we pay down the debt and absorb the 2001 price reduction in the power contract, to 2.54 mills per kilowatt-hour. Based on a reduction in long-term debt of $152 million in the last three years, we are confident that the retirement of CF(L)Co.'s debt in 2010 is within our grasp.

The Guaranteed Winter Availability Contract provides the opportunity for increased revenues; approximately $18 million in 2003, resulting from the dedicated commitment of employees to ensure that the additional capacity is available during the contract period each year.

In 2003, major upgrades to the Town Centre were completed – an investment of over $6 million, and a new Youth Centre will open in 2004. We are committed to providing our employees and their families with a strong and viable northern community in which to live and work.

A MANDATE OF CONTINUOUS IMPROVEMENT

To ensure that we are fulfilling our mandate to provide least cost, reliable power, we are concentrating on the costs that are within Hydro's control. We will continue to work in a focused and structured way to review our business processes and leverage technology to add value and eliminate waste. We are steadily progressing toward a culture that is performance-based and thinking strategically with clearly defined goals and objectives. We have also instituted appropriate performance measures to track our progress. In short, we have a very tight rein on the management of our resources to ensure that our customers are getting the value they deserve.

THE COMMITMENT OF OUR PEOPLE

With all of these initiatives, the achievements gained were totally dependent on the commitment and capability of our employees. Our new wellness initiative is intended to enhance the well-being of our workers. The reduction of stress in the workplace, improved health and lower absentee rates will increase efficiencies and reduce accidents to ensure our targeted exemplary safety record is achieved.

I would like to note the retirement of David W. Reeves, Vice-President, Transmission and Rural Operations, as of July 31, 2003, following a 31-year career with the Hydro Group of Companies. I extend my best wishes to Dave for a healthy and well-deserved retirement.

I would also like to thank the Board of Directors of Hydro and CF(L)Co. for their support and assistance throughout the year. On behalf of Board Members and Executive Management, I express our gratitude to all employees of the Hydro Group for their contribution throughout the year.

William E. Wells
President and Chief Executive Officer

Directly and indirectly, Hydro provides energy to more than 250,000 electrical consumers in Newfoundland and Labrador.

That's up to a million pieces of toast that we help make every morning.

2003 In Review

ABOUT NEWFOUNDLAND AND LABRADOR HYDRO

Newfoundland and Labrador Hydro ("Hydro") is a Crown Corporation, owned by the Province of Newfoundland and Labrador. With a dedicated workforce of 1190 full-time equivalents, including Churchill Falls (Labrador) Corporation ("CF(L)Co."), Hydro generates, transmits and distributes electrical power and energy to utility, industrial and residential customers throughout the Province.

Founded in 1954 as the Newfoundland Power Commission, with a mandate to promote rural electrification, Hydro was established as a Crown Corporation in 1975 and is currently governed by the Hydro Corporation Act and the Electrical Power Control Act. Hydro has a mandate to deliver reliable, least cost energy to the residents and industry in Newfoundland and Labrador.

Hydro is the parent company of the Hydro Group of Companies ("Hydro Group") comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited, Lower Churchill Development Corporation Limited ("LCDC"), Gull Island Power Company Limited ("GIPCo."), and Twin Falls Power Corporation Limited ("Twin Falls").

The Hydro Group's installed generating capacity is the fourth largest of all utility companies in Canada. Our power generating assets include 10 operating hydroelectric plants, one oil-fired plant, four gas turbines, 28 diesel plants and the Churchill Falls Hydro-electric Generating Station, the largest underground powerhouse in the world with a rated capacity of 5,428 megawatts ("MW") of power. Hydro also maintains over 4,700 km of transmission lines and over 3,600 km of lower voltage distribution lines.

Every year, Hydro generates over 80 per cent of the electrical energy consumed by Newfoundlanders and Labradorians. We are an integral part of the Province's electrical system. Hydro also distributes power directly to 35,000 customers in rural Newfoundland and Labrador, which represents about 15 per cent of the Province's electrical consumers. The challenge of providing power to rural, and often remote, communities that experience challenging weather conditions cannot be overstated. It is a balancing act of cost and reliability to meet the expectations of our customers. We continue to strive for operating efficiencies while providing quality service to our customers and making the right strategic investments to maximize performance.

Hydro engaged in a number of important initiatives and achieved significant milestones in 2003. From a year of record sales, another multi-faceted rate hearing, to the commissioning of the Granite Canal Hydroelectric Generating Station, the past year has certainly reflected the complexity of our operating environment. Despite the challenges, we are proud of our record of service and we will strive for continual improvement in all areas of our operation as we meet the energy needs of Newfoundland and Labrador.

OUR OPERATIONS – PROVIDING LEAST COST, RELIABLE ENERGY

- This is the third consecutive year of record energy sales, with a total energy supply of 7231 GWh, one per cent above 2002. On the Labrador Interconnected System record deliveries were 813 GWh, a 4.8 per cent increase over 2002. Growth in deliveries is a result of industrial sales in Labrador and sales to Newfoundland Power on the Island Interconnected System.
- The Holyrood Thermal Generating Station, an integral component of the Island Interconnected System, had a gross production of 2061 GWh in 2003, an 18 per cent reduction from 2002. Despite this decrease, the plant provided over 31 per cent of the Island Interconnected System's energy with increasingly efficient operations given the production levels. The plant burned over three million barrels of oil to meet the energy requirements at an average cost per barrel of $37.35.
- The Board of Commissioners of Public Utilities ("PUB") issued an order with respect to the Rate Stabilization Plan ("RSP") in December 2003. There were two outstanding balances in the RSP at the end of 2003. These two balances will now be combined and will be recovered from customers over a four-year period starting in January 2004. This change is intended to lessen the impact on customers of the growing balance in the plan due to high fuel costs and a short recovery time.
- Hydro is proud to have completed the construction of the Granite Canal Hydroelectric Generating Station in 2003. This 40 MW facility, within the existing Bay D'Espoir reservoir system, will provide over 220 GWh of required energy for the Island Interconnected System. It is an excellent source of environmentally-friendly, cost-effective energy for the Island that will benefit Newfoundlanders for years to come.
- To help meet the demand for capacity and energy on the Island Interconnected System, Hydro began purchasing power from Corner Brook Pulp and Paper and the Exploits River Partnership. This provided an additional 47 MW of capacity and 237 GWh of energy. Additional requirements for capacity and energy for the Island Interconnected System are not forecast until 2010.
- The addition of new capacity to meet the requirements of the Island Interconnected System, as well as other factors, resulted in Hydro filing a General Rate Application with the PUB for the second time within two years. The application filed in May 2003 is expected to result in a decision by the PUB in the first half of 2004.

OUR PEOPLE – INVESTING IN OUR STRONGEST RESOURCE

- Our goal is to have the best possible safety record. Safety will always be a priority because of the nature of the business in which we work. In 2003, despite the slight increase in the All Injury Frequency Rate from 1.98 to 2.10, Hydro recorded one less injury than in 2002 and the Severity Rate declined from 24.90 to 18.30.
- Hydro continues to invest in training and development for our employees to ensure that they have the skills and training they need to serve Newfoundlanders and Labradorians. This past year over 700 Hydro employees took part in training and skills upgrading.
- Hydro launched a new wellness program for employees called Wellness Works in 2003. This program is intended to enhance the well-being of Hydro employees, increase productivity, lower employee benefit costs and increase employee satisfaction.

2003 In Review

OUR PROVINCE AND OUR SYSTEM – INVESTING IN OUR FUTURE

- The Hydro Group's net income, before unusual items decreased by $14 million, or 24 per cent, while there was a three per cent increase in revenue. Power purchases were the primary reason for this decrease coupled with no commensurate rate increase for regulated sales. Hydro experienced a $2.6 million loss on regulated operations for the first time.
- The electrification of the Province began in earnest in the 1960s and there is a significant annual investment required in system upgrades to ensure reliability. Hydro invested over $67 million in its systems and operations throughout the province this past year, including the completion of Granite Canal. Significant projects were focused on enhancement of system reliability, safety and efficiency.
- In December 2003, an upgrade of the cross-island telecommunications network was completed. As part of the overall program to improve system protection, it will ensure the reliable transmission of system data between the generating and terminal stations and the Energy Control Centre.
- Noteworthy improvements were completed on rural distribution systems in Little Bay, St. Anthony, Bay D'Espoir, Bottom Waters and South Brook.
- Upgrades of the transmission systems near Stephenville and Sunnyside were completed; including the replacement and upgrades of equipment at terminals to enhance system performance and protection.

OUR ENVIRONMENT – MANAGING OUR RESOURCES

- Hydro's Transmission and Rural Operations Division met all the requirements for ISO 14001 certification in 2003. All Hydro Environmental Management Systems ("EMS") will now be registered. This is a significant accomplishment for all employees and reflects our commitment to responsible environmental management.
- As the Province's demand for energy increases, Hydro is committed to the responsible use of resources. In 2003, we launched our energy conservation program "Hydrowise". Hydrowise is an education initiative aimed at raising awareness about energy conservation and assisting electrical consumers to manage their energy use.
- As part of its continuing commitment to the environment, and in support of our environmental management system, the development at Granite Canal included the construction of a 45,000 m^2 Fish Habitat Compensation Facility. This facility provides spawning and rearing habitat for landlocked salmon and brook trout and included a number of innovative features in its construction and design.
- Hydro invested over $1.5 million at its Holyrood Thermal Generating Station in Continuous Emissions Monitoring and upgraded Ambient Air Monitoring Systems. These investments will allow the plant to address environmental and efficiency concerns in a more effective and timely manner.
- Hydro continues to work with its Community Liaison Committee in Holyrood to ensure that a high level of communication is maintained between the plant and the surrounding communities. The committee met six times in 2003 to review operational and environmental information.

All Newfoundland and Labrador Hydro Environmental Management Systems are ISO 14001 certified and registered. We're committed to excellence in environmental management.

Whenever you flick the switch you can be sure the electricity you use is produced according to high environmental standards.

Management's Discussion and Analysis

Management's Discussion and Analysis highlights the primary factors that have an impact on the financial results and operations of the Corporation. It should be read in conjunction with the audited financial statements and the accompanying notes.

Newfoundland and Labrador Hydro ("Hydro") is a Crown Corporation, owned by the Province of Newfoundland and Labrador ("Province"). Hydro generates, transmits and distributes electrical power and energy to utility, residential and industrial customers throughout the Province.

Hydro is the parent company of the Hydro Group of Companies ("Hydro Group") comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co."), Lower Churchill Development Corporation Limited ("LCDC"), Gull Island Power Company Limited ("GIPCo."), and Twin Falls Power Corporation Limited ("Twin Falls"). The Hydro Group's installed generating capacity is the fourth largest of all utility companies in Canada. Our power generating assets consist of 10 hydroelectric plants, including the Churchill Falls hydraulic plant, which is the largest underground powerhouse in the world with a rated capacity of 5,428 megawatts (MW) of power, one oil-fired plant, four gas turbines and 28 diesel plants.

FINANCIAL OVERVIEW

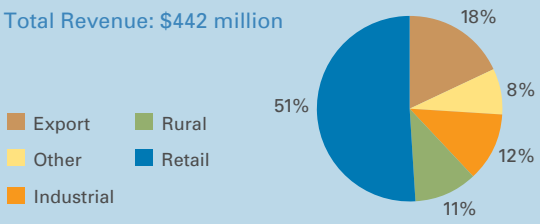
In 2003, Hydro experienced a net loss of $74.6 million on a consolidated basis. This loss is primarily the result of Management's review of the carrying balances for project costs and capital studies related to future hydroelectric development in Labrador. As Hydro has been unable to conclude development plans at this time, the decision has been made to write-down project costs in GIPCo. by $96.3 million, capital studies in LCDC by $25 million and construction in progress by $9.6 million. Although the net impact of these unusual write-downs on Hydro's income statement is a reduction in net income of $118.6 million, the project costs and capital studies were fully funded by the shareholder in prior years through the provision of contributed capital.

Net income for 2003, before unusual write-downs, was $44 million, a decrease of $14.0 million compared to 2002. Income was down 24% mainly due to an increase in purchased power costs. Debt levels rose in 2003 to finance a portion of capital expenditures as well as fuel costs deferred in the Rate Stabilization Plan ("RSP").

The Hydro Group has a workforce of approximately 1,190 full-time equivalents, a reduction of 2.5% compared to 2002.

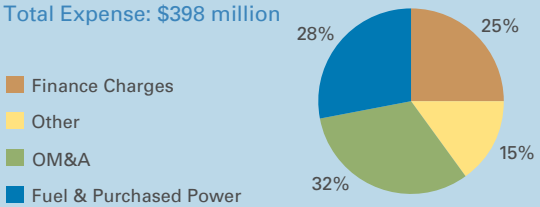
2003 Revenue

Total Revenue: $442 million



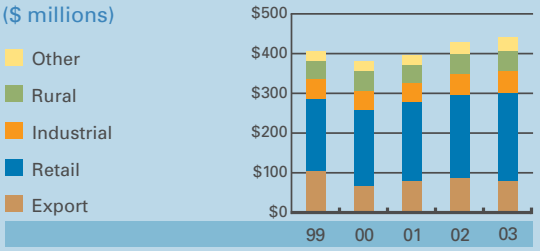
2003 Expense

Total Expense: $398 million



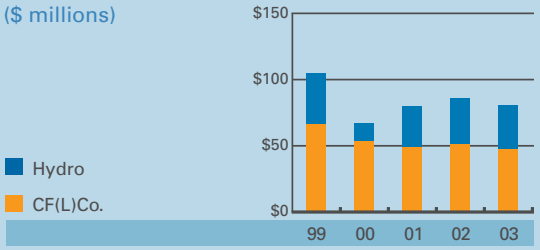
Five-Year Summary of Revenue

($ millions)



Five-Year Summary of Export Sales

($ millions)



COMPOSITION OF REVENUE AND EXPENSE

Hydro's revenue consists of sales of electricity to several large industrial customers in the Province and over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Hydro also sells energy to Newfoundland Power, an investor-owned utility that distributes electrical power to the balance of the population

on the island portion of the Province. Export sales consist of power generated at Churchill Falls and sold to Hydro-Québec. The majority of these sales are made directly by CF(L)Co. to Hydro-Québec at rates set under a long-term power contract. The remainder is sold to Hydro-Québec by Hydro at market rates.

The Corporation's major expense categories consist of fuel and purchased power, operating, maintenance and administration, finance charges and depreciation.

NET INCOME

Hydro's consolidated net income before unusual items was $44 million in 2003, a decrease of $14.0 million from 2002. Over the past five years, Hydro has paid $309 million in dividends to the Province.

REVENUE

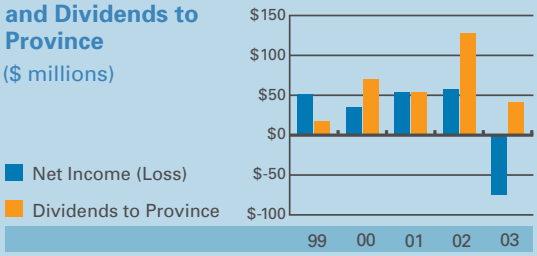
Total revenue growth in 2003 was approximately 3%, mainly due to continued load growth for the utility customer, and the full year's effect of a general rate increase to regulated customers approved by the PUB effective September 2002. Also contributing to higher revenue was additional compensation from the Guaranteed Winter Availability Contract between CF(L)Co. and Hydro-Québec.

EXPENSES

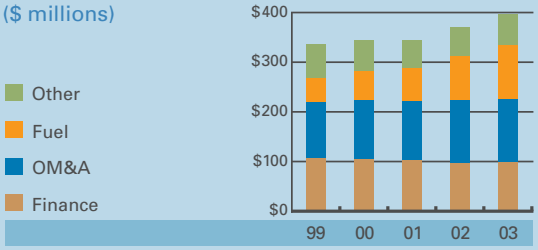
Total expenses for 2003 were 8% higher than 2002 primarily due to a 16% increase, or $11.4 million, in fuel costs and a 65% increase, or $10.3 million, in purchased power costs. The increase in fuel costs is due to higher fuel prices in base rates. In 2003, 19¢ of every dollar of revenue went to pay for fuel costs compared to 17¢ in 2002. The increase in purchased power costs is due to more energy supplied by non-utility generators through new contracts with Corner Brook Pulp and Paper Limited and the Exploits River Hydro Partnership. These higher costs are not currently incorporated in electrical rates and are one of the reasons behind the filing of a general rate application during 2003.

Hydro pays various fees, taxes and other charges as indicated below:

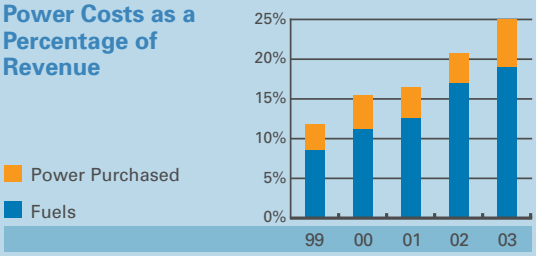
Five-Year Summary of Net Income (Loss) and Dividends to Province
($ millions)



Five-Year Summary of Expense
($ millions)



Five-Year Summary of Fuel and Purchased Power Costs as a Percentage of Revenue



Fees, Taxes and Water Rentals (millions of dollars)		**2003**	2002
Payment	**Recipient**		
Debt Guarantee Fee	Government of Newfoundland and Labrador	**$ 13.9**	$ 12.2
Payroll Tax	Government of Newfoundland and Labrador	**1.2**	1.1
Rentals and Royalties	Government of Newfoundland and Labrador	**4.8**	4.4
Municipal Taxes	Various Newfoundland and Labrador Municipalities	**1.3**	1.0
Total		**$ 21.2**	$ 18.7

OPERATIONS AND ADMINISTRATION

Overall, operations and administration expenses were consistent with 2002. In 2003, 28¢ out of every dollar in revenue went to pay for operations and administration. This is down from 29¢ in 2002.

FINANCE CHARGES

Interest expense, including the guarantee fee, increased by $1.5 million to $99.3 million, primarily due to higher outstanding debt balances, offset by lower interest rates.

CAPITAL EXPENDITURES

In order to ensure a safe, reliable and cost-effective supply of electricity for its customers, Hydro invested $67 million in various capital projects during 2003, compared to $110 million in 2002. Major capital investments in 2003 included:

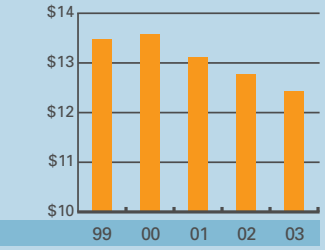
- $26 million to complete 40 MW of hydraulic generation capacity at Granite Canal situated within the existing Bay D'Espoir Development, which was brought in service in June 2003.
- $9 million for the interconnection of the microwave system between the east and west coast of the Island.
- $6 million related to the improvements to the Distribution System along with additions for new customers.
- $5 million related to the potential development of hydro projects in Labrador.
- $4 million for improvements at the Holyrood Thermal Generating Station.

BORROWING AND DEBT

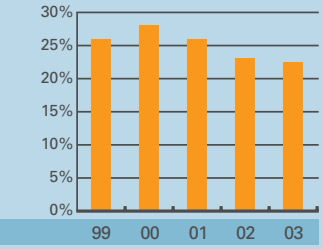
Hydro borrowed $125 million of long-term Canadian denominated debt in 2003. Funds from these borrowings were used to finance a portion of the Corporation's capital expenditures, and the cost of fuel deferred in the RSP. The Corporation also reduced promissory notes outstanding by $31.7 million. Additionally, $19.2 million was invested in sinking funds.

Hydro's net debt increased to $1,558 million at December 31, 2003, from $1,538 million at December 31, 2002.

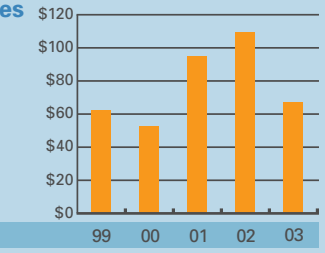
Controllable Unit Cost
($/MWh)



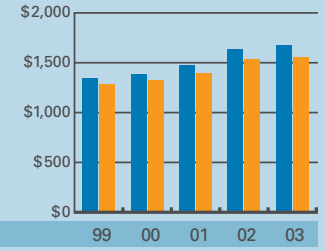
Five-Year Summary of Finance Charges as a Percentage of Revenue



Five-Year Summary of Capital Expenditures
($ millions)



Debt Outstanding at December 31
($ millions)



PERFORMANCE INDICATORS

Hydro has a well developed strategic planning process to provide long-term direction, including the identification of corporate strategic issues and objectives. One of the stated objectives is: "To optimize corporate performance". Several key indicators of corporate performance are relied upon to measure progress in this regard. The financial indicators reflect Hydro's operating results only, exclusive of subsidiary activity.

Return on equity and the interest coverage ratio decreased from 2002, primarily due to a lower net income arising from higher purchased power costs which are not reflected in rates. This, coupled with increased borrowing required to fund the capital program and growing RSP balances, caused the debt to capital percentage to increase during 2003 as well. There was an improvement in unit cost performance in 2003 due to an increase in energy delivered and a decrease in controllable costs.

Financial Performance Indicators (Hydro only)	**2003**	2002	2001
Debt to Capital (%)	**86**	85	79
Return on Equity (%)	**8.6**	15.9	13.5
Interest Coverage Ratio	**1.15**	1.37	1.38
Controllable Unit Cost ($/MWh)	**12.42**	12.77	13.12

Non-Financial Performance Indicators	**2003**	2002	2001
Generated Energy (GWh)	**37,317**	39,421	36,496
SAIFI – Transmission	**2.59**	1.72	1.43
SAIFI – Distribution	**7.86**	9.44	7.47
SAIDI – Transmission (minutes)	**222.34**	106.72	44.00
SAIDI – Distribution (hours)	**11.90**	13.63	10.17
All Injury Frequency Rate	**2.10**	1.98	2.17
Customer Satisfaction Index	**7.9**	8.1	7.9

DESCRIPTION OF PERFORMANCE INDICATORS

RETURN ON EQUITY – Net Income/Average Equity.

DEBT TO CAPITAL – Year-end debt balance expressed as a percentage of the total corporate financing structure.

INTEREST COVERAGE RATIO – The extent to which income before financing charges is able to cover the corporation's interest obligations.

SYSTEM AVERAGE INTERRUPTION FREQUENCY INDEX (SAIFI) – Total number of sustained outages/ total number of delivery points or customers. An outage is sustained if over one minute in duration. For transmission, denominator is delivery points; for distribution it is customers. This is used to track the overall performance of Hydro's transmission and distribution system.

SYSTEM AVERAGE INTERRUPTION DURATION INDEX (SAIDI) – Total duration of all outages/number of delivery points or customers. Transmission is measured in minutes and the denominator is delivery points. Distribution is measured in hours and the denominator is customers.

GENERATED ENERGY (GWH) – The volume of electricity that was generated from Hydro's generating facilities.

ALL INJURY FREQUENCY RATE – (# of disabling injuries + # of medical aid injuries) * 200,000 / hours worked. It measures the frequency with which injuries occur.

CONTROLLABLE UNIT COST – Controllable Corporate Operating, Maintenance and Administrative Cost/ energy deliveries (MWh).

CUSTOMER SATISFACTION INDEX – The weighted average of satisfaction ratings of the service attributes, based on annual rural residential customer survey.

HYDRO SUBSIDIARIES

Hydro has one wholly owned subsidiary, GIPCo., as well as a 51% interest in LCDC and a 65.8% interest in CF(L)Co. CF(L)Co. is accounted for as a joint venture and therefore only Hydro's proportionate share of its financial statement items appears below.

REGULATION

In May 2003, Hydro filed a general rate application with the Board of Commissioners of Public Utilities ("PUB") primarily seeking to recover costs of new power purchase contracts as well as the costs of the Granite Canal Hydroelectric project which came on-stream in mid-2003. Other matters were also addressed in the hearing including corporate financial targets, rural rate setting, the rural deficit and fuel costs. Information was also presented to the PUB on a demand and energy rate structure for Newfoundland Power as a potential replacement for the current rate form which is based solely on energy sales. A number of issues were settled during a mediation process, introduced for the first time in a Hydro rate hearing. Additionally, the parties were able to negotiate a revised structure for the rate stabilization plan, which has been approved by the PUB. Important issues remain to be ruled on by the PUB, including Hydro's application for a market-based rate of return on equity.

The hearing into Hydro's rate application commenced before the PUB in September and final legal arguments concluded in January 2004. It is anticipated that the PUB report will be issued in order that new rates can become effective during the second quarter.

Net Income

	Hydro (Unconsolidated)	CF(L)Co.	GIPCo.	LCDC	Eliminating Entries	Hydro (Consolidated)
(millions of dollars)			2003			
Revenue	$ 377.3	$ 65.6	$ -	$ -	$ (1.4)	$ 441.5
Expenses	349.6	48.4	-	-	(0.5)	397.5
Write-down of assets	22.3	-	96.3	25.0	(25.0)	118.6
Net Income (loss)	$ 5.4	$ 17.2	$ (96.3)	$ (25.0)	$ 24.1	$ (74.6)

Balance Sheet

(millions of dollars)			2003			
Total Assets	$ 2,110.9	$ 372.0	$ 3.7	$ 5.2	$ (260.5)	$ 2,231.3
Liabilities	$ 1,636.7	$ 118.5	$ -	$ -	$ (1.8)	$ 1,753.4
Equity	474.2	253.5	3.7	5.2	(258.7)	477.9
Total Liabilities and Equity	$ 2,110.9	$ 372.0	$ 3.7	$ 5.2	$ (260.5)	$ 2,231.3

OUTLOOK FOR 2004

Earnings are expected to be higher in 2004 due to a projected increase in rates effective in the 2nd quarter of the year. Also, the total outstanding balances owing to Hydro from customers primarily related to deferred fuel charges in the RSP is forecast to decline to $140 million by the end of 2004.

RATE STABILIZATION PLAN ("RSP")

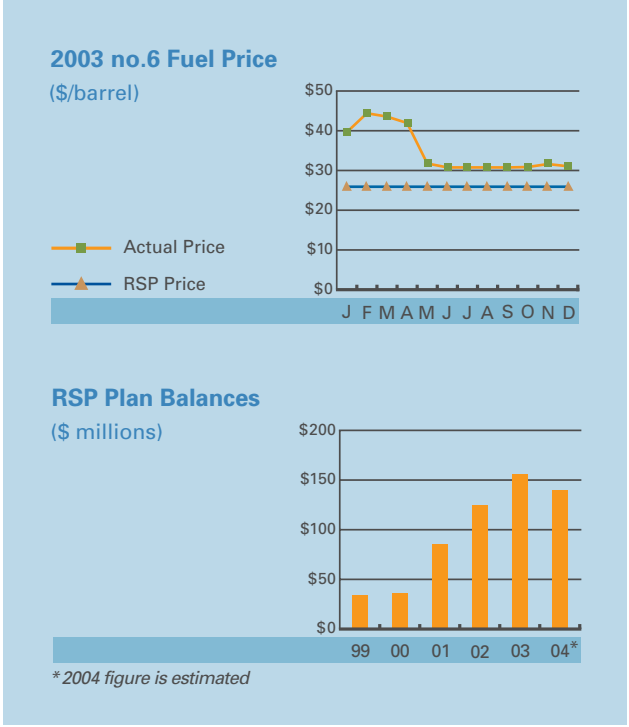
Prior to September 2002, the price of no. 6 fuel in the base rates to be charged to consumers was $12.50 per barrel. As fuel prices rose the difference between the cost of fuel consumed and the cost upon which rates were set accumulated in the RSP, resulting in a balance owing to Hydro from its customers of $105.8 million at the end of August 2002, at which point, this balance was frozen and is to be recovered over a five-year period which commenced in 2003. As of December 31, 2003, $94.6 million remains to be recovered.

In September 2002, the price of no. 6 fuel was reset to $25.91 per barrel, which was the forecast price for 2002 at that time. However, during 2002 the average price per barrel consumed climbed to $36 by year-end and continued to climb until it reached $44 in February 2003 and then dropped to $31 in May where it stayed through the remainder of the year. As at December 31, 2003, an additional amount of $61.1 million owing to Hydro from its customers had accumulated in the RSP. This was to be recovered over a two-year period starting in 2004. However, the PUB has approved a negotiated proposal for restructuring the RSP, an element of which is that this balance be consolidated with the frozen August 2002 plan balance and recovered over the next four years.

Based on a current forecast fuel price of $29.05 per barrel, Hydro is projecting a new RSP balance of $5.2 million to accumulate by year-end 2004. This balance will be recovered in 2005, with the exception of the hydraulic variation, which will be recovered at a rate of 25% annually. Additionally, a fuel rider will be calculated based on the 2005 forecast fuel price and will be added to or subtracted from the electrical rates that would otherwise be in effect.

HUMAN RESOURCES

Human resource management including recruitment and retention of a qualified workforce, compensation, training and development and succession planning will continue to be key to Hydro's continued success as 25% of its workforce will be eligible for retirement over the next five years. Fostering cooperative relations with Hydro's bargaining units is also key for future success.



INFRASTRUCTURE AND TECHNOLOGY

Hydro's generation and transmission facilities were constructed primarily during the 1960s to the 1970s. Many facilities are now approaching 40 years of age and require increasing amounts of maintenance to maintain acceptable levels of reliability. Significant capital investment is also required each year to ensure that facilities and equipment are upgraded, replaced or installed to meet the increasing demand for electrical energy from our customers.

New developments in generation, transmission and distribution, and metering technologies will affect the way the Corporation operates in the future. Renewable energy sources such as wind may eventually also offer potential for cost-effective generation of power.

ENVIRONMENT

Environmental issues are a significant consideration for electric utilities. In an effort to continue to provide reliable service while realizing its responsibility to the environment, Hydro adopted the ISO 14001 Environmental Management System ("EMS") standard in 1997 and has successfully implemented it throughout our operation. ISO 14001 is the foundation of the Canadian Electrical Industry's Environmental Commitment and Responsibility Program. This international standard of environmental management requires organizations to make a commitment to comply with legal and other requirements, prevent pollution and work to continually improve their environmental performance.

RISK MANAGEMENT

Hydro operates in an environment that entails various forms of business and financial risk. Some of these risks afford Hydro added opportunities, but others expose the company to risk and uncertainty that may lead to adverse impacts on our financial position and corporate objectives.

The Corporation is subject to business risks associated with damage of its assets, interruption of service and liability claims. The Hydro Group recognizes these exposures and employs a variety of risk control and financing techniques. Regular maintenance and inspection of assets, redundancy of critical facilities and other loss prevention solutions are utilized to eliminate and/or reduce these exposures. The Corporation purchases an insurance program to finance certain potential losses. This program is reviewed at least annually to ensure the appropriate coverages are purchased at the most reasonable cost. In 2003, a new three-year insurance policy was negotiated to protect our major assets at a lower rate than the expiring coverage. Self-insurance, insurance deductibles and reviews of exposures are also used to reduce the cost of risk.

As an electrical utility, the working environment for the majority of Hydro's employees is hazardous and unforgiving. To ensure that its employees are protected from accidents and industrial illness, Hydro has established a comprehensive Safety and Health Program. The program draws on industry best practices, state of the art personal protective equipment, task analysis and standardized work methods, and engineered solutions to provide employees with a safe environment in which to work. The safety and well-being of its workforce and the general public is a priority for Hydro.

Financial risks include changes in interest rates and fluctuation in foreign currency exchange rates. The Corporation manages its exposure to interest rates through an ongoing benchmarking against key indices, having due consideration for the company's relative risk profile. This approach has been instrumental in allowing the company to benefit from the recent lows in interest rate levels. The company mitigates its foreign exchange exposure through a diversified approach that includes the periodic use of forward currency contracts.

BUSINESS PROCESS IMPROVEMENT

In 2002, Hydro developed a structured program to review core business processes, as part of an overall continuous improvement program. The program is governed by process metrics and monitored by corporate key performance indicators.

A senior management improvement team, headed by an Executive Director, and various process improvement teams, continue to review and redesign corporate core processes.

Hydro's objective as part of its strategic plan focused on performance, is to eliminate non-value added work in its business processes and leverage the functionality of its integrated software suite to support process improvement and deliver better business information, effective work management tools, effective budgeting tools and process metrics.

Hydro wants to make sure that you get the most out of your energy usage. Our Hydrowise program helps consumers to make wise choices and reduce their energy consumption.

Turn your thermostats to 16˚C at night and whenever you leave the house for more than 8 hours. Turning back the heat can save 2% for every reduced degree.

Management Report

The accompanying consolidated financial statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 6, 2004. Financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis, and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditor, Deloitte & Touche LLP, is to express an independent, professional opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfils its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with Management, the internal auditors and the external auditors to satisfy itself that each group has properly discharged its respective responsibility and to review the financial statements before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.

John C. Roberts
Vice-President, Finance and Chief Financial Officer

William E. Wells
President and Chief Executive Officer

Auditors' Report

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2003, and the consolidated statements of loss and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

The financial statements as at December 31, 2002, and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 14, 2003.

Chartered Accountants
St. John's, Newfoundland and Labrador
Canada
February 6, 2004

Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2003**	2002
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,632.5**	2,604.7
Less contributions in aid of construction	**106.5**	108.9
	2,526.0	2,495.8
Less accumulated depreciation	**780.5**	745.7
	1,745.5	1,750.1
Construction in progress	**47.5**	154.6
	1,793.0	1,904.7
Current assets		
Cash and cash equivalents	**0.1**	0.2
Accounts receivable	**56.5**	62.0
Current portion of long-term receivables (Note 3)	**35.5**	27.5
Fuel and supplies at average cost	**48.5**	48.0
Prepaid expenses	**2.5**	2.5
	143.1	140.2
Long-term receivables (Note 3)	**130.7**	110.6
Sinking funds (Note 9)	**70.1**	48.7
Investments (Note 4)	**5.2**	5.2
Rate stabilization plan	**-**	20.5
Deferred charges (Note 6)	**89.2**	89.4
	2,231.3	2,319.3

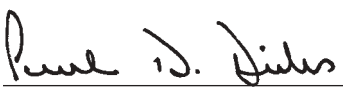
See accompanying notes

Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2003**	2002
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,447.8**	1,354.9
Current liabilities		
Bank indebtedness	**6.7**	4.4
Short-term borrowing	**1.8**	3.3
Accounts payable and accrued liabilities	**51.6**	59.3
Accrued interest	**30.5**	27.7
Long-term debt due within one year (Note 7)	**30.7**	50.2
Promissory notes (Note 7)	**149.8**	181.5
	271.1	326.4
Employee future benefits (Note 8)	**32.0**	29.6
Non-controlling interest in LCDC (Note 2)	**2.5**	14.8
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Notes 2 and 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**100.0**	100.0
Retained earnings	**337.8**	453.5
	477.9	593.6
Commitments and contingencies (Note 11)	-	-
	2,231.3	2,319.3

See accompanying notes

On behalf of the Board:



Paul Dicks
Director

Elmer Harris
Director

Consolidated Statement of Loss and Retained Earnings

Year ended December 31 (millions of dollars)	**2003**	2002
Revenue		
Energy sales	**407.8**	399.6
Recovery of costs in rate stabilization plan	**16.7**	14.0
Guaranteed winter availability	**11.9**	9.5
Rentals and royalties	**0.3**	0.3
Other	**4.8**	4.2
	441.5	427.6
Expenses		
Operations and administration	**125.8**	125.8
Fuels	**84.6**	73.2
Amortization of costs in rate stabilization plan	**16.7**	14.0
Power purchased	**26.1**	15.8
Depreciation	**45.0**	43.0
Interest (Note 10)	**99.3**	97.8
	397.5	369.6
Net income before unusual items	**44.0**	58.0
Unusual items (Note 2)		
Write-down of capital assets	**(130.9)**	-
Less non-controlling interest	**12.3**	-
	(118.6)	-
Net (loss) income	**(74.6)**	58.0
Retained earnings, beginning of year	**453.5**	523.5
	378.9	581.5
Dividends	**41.1**	128.0
Retained earnings, end of year	**337.8**	453.5

See accompanying notes

Consolidated Statement of Cash Flows

Year ended December 31 (millions of dollars)	**2003**	2002
Cash provided by (used in)		
Operating activities		
Net income (loss)	**(74.6)**	58.0
Adjusted for items not involving a cash flow		
Depreciation	**45.0**	43.0
Amortization of deferred charges	**4.1**	4.0
Rate stabilization plan	**20.5**	64.5
Other	**3.4**	-
Foreign exchange gain	**(1.0)**	(0.1)
Write-down of capital assets (net of non-controlling interest)	**118.6**	-
	116.0	169.4
Change in non-cash balances related to operations		
Accounts receivable	**5.5**	(5.6)
Fuel and supplies	**(0.5)**	(1.7)
Prepaid expenses	**-**	(0.5)
Accounts payable and accrued liabilities	**(8.2)**	11.8
Accrued interest	**2.8**	2.2
Employee future benefits	**2.4**	1.1
Long-term receivable	**(49.6)**	(104.8)
	68.4	71.9
Financing activities		
Long-term debt issued	**125.0**	250.0
Long-term debt retired	**(36.8)**	(138.1)
Foreign exchange loss recovered	**5.2**	8.5
Increase (decrease) in short-term borrowing	**(1.5)**	3.3
Increase (decrease) in promissory notes	**(31.7)**	43.5
Dividends	**(41.1)**	(128.0)
	19.1	39.2
Investing activities		
Net additions to capital assets	**(67.3)**	(109.7)
Decrease in short-term investments	**-**	4.0
Increase in sinking funds	**(19.2)**	(14.1)
Reductions (additions) to deferred charges	**(3.9)**	6.7
Change in accounts payable related to investing activities	**0.5**	(1.2)
	(89.9)	(114.3)
Net decrease in cash	**(2.4)**	(3.2)
Cash position, beginning of year	**(4.2)**	(1.0)
Cash position, end of year	**(6.6)**	(4.2)
Cash position is represented by		
Cash and cash equivalents	**0.1**	0.2
Bank indebtedness	**(6.7)**	(4.4)
	(6.6)	(4.2)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.6**	1.7
Interest paid	**109.6**	104.1

See accompanying notes

Notes to Consolidated Financial Statements

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador ("Province") as a Crown Corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited ("Twin Falls"), are exempt from paying income taxes under Section 149 (1)(d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations

(Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are regulated on the basis of return on rate base. As well, Hydro's borrowing and capital expenditure programs are subject to review and approval by the Public Utilities Board ("PUB").

Rates charged rural customers do not recover the full costs of providing the service but Hydro recovers the resulting deficit from other customers.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited ("GIPCo."), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co.") and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. subsequent to the effective date of the shareholders' agreement.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,000 kilowatts ("CF(L)Co. Project"). A power contract with Hydro-Québec, dated May 12, 1969 ("Power Contract") provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. CF(L)Co. receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

CF(L)Co. holds 33.33% of the equity share capital of Twin Falls Power Corporation Limited and is a party with other shareholders in a participation agreement which gives CF(L)Co. joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

The cost of Hydro's investment in CF(L)Co. exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2003, $33.6 million (2002 - $32.4 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo. is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland ("Gull Island Project"), (Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River ("Lower Churchill Development"), (Note 4).

Twin Falls is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents, whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which

approximates market value. As at December 31, 2003, and 2002, there were no cash equivalents or short-term investments outstanding.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo. and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro makes provision in its accounts for future removal and site restoration costs over the life of new assets, when such costs can be reasonably estimated and it is not expected that the asset will be replaced at the same location. For existing assets which are not expected to be replaced at the same location, net salvage costs are amortized after retirement. If an asset is expected to be replaced at the same location, net salvage costs are amortized over the life of the replacement asset.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co.

CF(L)Co. uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

CF(L)Co. has made no provision in its accounts for future removal and site restoration costs as they cannot be estimated at this time.

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan ("RSP") which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan do not require a reference to the PUB and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

In 2002, the PUB ordered changes with respect to the recovery of the balance in the RSP, as well as for any future balances that may accumulate. The RSP balance as at August 31, 2002, has been converted to a long-term receivable and the balance outstanding at December 31, 2002, is to be recovered over a five-year period, which commenced in 2003 (Note 3). In 2003, the PUB further ordered that the RSP activity for the period September - December 2002 and all of 2003 be consolidated with the August 2002 balance. Any subsequent balances accumulating in the RSP are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered at a rate of 25% of the outstanding balance at year-end.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

Promissory Notes

Promissory Notes bear interest from 2.66% to 2.93% per annum (2002 - 2.80% to 3.29%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2002 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date.

(i) In the case of Hydro, foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. This amortization is included in interest expense. Commencing in 2002, the PUB ordered Hydro's deferred foreign exchange losses, net of the $10.0 million provision previously accumulated, be amortized over a forty-year period (Note 6).

(ii) Under the provisions of the Power Contract CF(L)Co.'s exposure for a foreign exchange loss is limited. CF(L)Co. recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 3).

Financial Instruments

From time to time, Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

2. CAPITAL ASSETS

millions of dollars	Capital Assets in Service	Contributions in Aid of Construction	Accumulated Depreciation	Construction in Progress
		2003		
Generation Plant				
Hydroelectric	**1,347.3**	**20.5**	**267.0**	**0.2**
Thermal	**227.0**	**-**	**175.7**	**-**
Diesel	**59.5**	**6.7**	**23.4**	**-**
Transmission and Distribution	**718.2**	**54.9**	**168.5**	**0.6**
Service facilities	**22.0**	**-**	**9.8**	**-**
Project costs (Note 4)	**-**	**-**	**-**	**-**
Capital studies (Note 4)	**-**	**-**	**-**	**-**
Other	**258.5**	**24.4**	**136.1**	**46.7**
	2,632.5	**106.5**	**780.5**	**47.5**

millions of dollars		2002		
Generation Plant				
Hydroelectric	1,243.6	20.5	256.1	102.7
Thermal	223.5	-	173.3	0.2
Diesel	62.5	7.9	23.1	0.1
Transmission and Distribution	693.3	56.0	155.7	1.0
Service facilities	22.0	-	9.5	-
Project costs (Note 4)	96.4	-	-	-
Capital studies (Note 4)	25.0	-	-	-
Other	238.4	24.5	128.0	50.6
	2,604.7	108.9	745.7	154.6

Included in the above amounts are CF(L)Co. assets in service amounting to $636.1 million (2002 - $633.6 million) which are pledged as collateral for long-term debt.

Management has reviewed the carrying balance of its Capital Assets in Service and Construction in Progress for hydro-electric developments in Labrador. As Hydro has been unable to successfully conclude development plans at this time, it has decided to write-down project costs related to GIPCo. by $96.3 million, capital studies related to LCDC by $25.0 million, and construction in progress by $9.6 million, to its best estimate of the net recoverable amount. The write-down of capital studies also results in a reduction of $12.3 million in the non-controlling interest in LCDC. The project costs in GIPCo. and capital studies in LCDC were funded by the shareholder in prior years through the provision of contributed capital.

3. LONG-TERM RECEIVABLES

millions of dollars	**2003**	2002
Rate Stabilization Plan		
Retail	**114.8**	76.3
Industrial	**40.9**	28.0
	155.7	104.3
Hydro-Québec		
Unrealized foreign exchange	**9.5**	31.1
Other	**1.0**	2.7
	10.5	33.8
Less current portion of long-term receivables	**35.5**	27.5
	130.7	110.6

The receivable arising from the RSP bears interest at the weighted average cost of capital which is approximately 7.2% and is to be recovered over a five-year period, which commenced in 2003.

The other long-term receivable from Hydro-Québec bears interest at 7% per annum and is receivable over a four year period which commenced in September 2000.

4. INVESTMENTS

millions of dollars	**2003**	2002
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement ("Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, ("Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, ("Option Agreement"). The purchase price in respect of GIPCo.'s assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2004.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

5. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2003, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2003.

millions of dollars	**2003**	2002
Current assets	**24.0**	34.6
Long-term assets	**347.9**	371.7
Current liabilities	**29.4**	45.3
Long-term liabilities	**84.0**	113.9
Revenues	**61.7**	62.9
Expenses	**48.5**	49.0
Net income	**13.2**	13.9
Cash provided by (used in)		
Operating activities	**34.1**	25.4
Financing activities	**(30.4)**	(24.3)
Investing activities	**(2.6)**	1.6

6. DEFERRED CHARGES

millions of dollars	**2003**	2002
Debt discount, financing expenses and other	**20.1**	19.6
Accumulated amortization	**12.9**	14.3
	7.2	5.3
Foreign exchange losses realized	**96.3**	96.3
Accumulated provision	**10.0**	10.0
	86.3	86.3
Accumulated amortization	**4.3**	2.2
	82.0	84.1
Net deferred charges	**89.2**	89.4

7. LONG-TERM DEBT

	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
millions of dollars		**2003**			2002	
Summary of long-term debt						
Long-term debt	**1,377.2**	**101.3**	**1,478.5**	1,257.1	148.0	1,405.1
Less payments due within one year	**13.4**	**17.3**	**30.7**	16.1	34.1	50.2
	1,363.8	**84.0**	**1,447.8**	1,241.0	113.9	1,354.9

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2004	2005	2006	2007	2008
	30.7	29.3	228.3	20.9	213.7

The payments due within one year include sinking fund requirements of $10.0 million (2002 - $8.8 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2003**	2002	
AC	5.05	2001	2006	**200.0**	200.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	300.0	(a)
AD	5.70	2003	2033	**125.0**	-	(a)
Total debentures				**1,400.0**	1,275.0	
Less sinking fund investments in own debentures				**43.8**	46.0	
				1,356.2	1,229.0	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**18.8**	25.1	
Other				**2.2**	3.0	
				1,377.2	1,257.1	
Less payments due within one year				**13.4**	16.1	
				1,363.8	1,241.0	

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co.

millions of dollars	**2003**	2002
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $43.6; 2002 - U.S. $63.4)	**56.4**	100.2
7.875% Series B due December 15, 2007	**4.4**	6.4
General Mortgage Bonds		
7.500% due December 15, 2010	**40.5**	41.4
	101.3	148.0
Less payments due within one year	**17.3**	34.1
	84.0	113.9

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however fixed sinking fund payments are estimated to average $13.2 million in each of the years 2004 to 2008 inclusive.

Under the terms of long-term debt instruments, CF(L)Co. may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999, places additional restrictions on dividends, based on cash flow.

8. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of $4.1 million (2002 - $3.6 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. Information about these plans is as follows:

millions of dollars	**2003**	2002
Accrued benefit obligation		
Balance at beginning of year	**37.5**	28.5
Current service cost	**1.3**	0.9
Interest cost	**2.6**	2.0
Actuarial loss	**-**	7.5
Past service cost	**-**	0.4
Benefits paid	**(1.9)**	(1.8)
Balance at end of year	**39.5**	37.5
Plan deficit	**39.5**	37.5
Unamortized actuarial loss	**(7.1)**	(7.5)
Unamortized past service cost	**(0.4)**	(0.4)
Accrued benefit liability at end of year	**32.0**	29.6

8. EMPLOYEE FUTURE BENEFITS (Cont'd.)

The most recent actuarial valuation was performed as at December 31, 2002. The significant actuarial assumptions used in measuring the company's accrued benefit obligations include a discount rate of 7.0% and an average rate of compensation increase of 3.5%. In addition, in determining the expected cost of healthcare benefits, it was assumed that healthcare costs will increase by 12.0% in 2003, and decrease gradually to 5.0% in 2010 and remain level thereafter.

The net benefit plan expense is as follows:

millions of dollars	**2003**	2002
Current service cost	**1.3**	0.9
Interest cost	**2.6**	2.0
Amortization of actuarial loss	**0.4**	-
Net benefit plan expense	**4.3**	2.9

9. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2003, and 2002 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
millions of dollars	**2003**		2002	
Financial Assets				
Sinking funds	**70.1**	**76.3**	48.7	54.2
Long-term receivable including amount due in one year	**166.2**	**166.2**	138.1	138.2
Financial Liabilities				
Long-term debt including amount due in one year	**1,478.5**	**1,769.6**	1,405.1	1,670.4

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2003, of the total accounts receivable balance outstanding approximately 50.0% (2002 - 46.9%) is due from a regulated utility, and 24.0% (2002 - 25.1%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2031. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 5.33% to 9.86% (2002 - 5.80% to 10.55%).

10. INTEREST EXPENSE

millions of dollars	**2003**	2002	
Gross interest			
Long-term debt	**109.9**	105.3	
Promissory notes	**5.7**	5.0	
	115.6	110.3	
Amortization of debt discount and financing expenses	**1.0**	1.3	
Provision for foreign exchange losses	**2.2**	2.2	
Foreign exchange gain	**(1.0)**	(0.1)	
	117.8	113.7	
Less			
Recovered from Hydro-Québec	**3.2**	5.3	(a)
Interest capitalized during construction	**7.3**	7.7	
Interest earned	**21.9**	15.1	
Net interest expense	**85.4**	85.6	
Debt guarantee fee	**13.9**	12.2	
Net interest and guarantee fee	**99.3**	97.8	

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co. can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co. can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

11. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co. is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

The results of a recent Environmental Site Assessment ("ESA") conducted at the Twin Falls Generating Station indicate higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing is to be conducted to determine the extent of contamination, and a remediation plan will be developed in consultation with regulatory agencies. At this time the magnitude of potential liability cannot be estimated due to insufficient knowledge of the extent of contamination. Further, there is uncertainty with respect to whether Twin Falls or CF(L)Co. is responsible for any environmental liabilities that are determined to exist.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately $16.2 million (2002 - $6.4 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $22.4 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $14.1 million at December 31, 2003 (2002 - $23.8 million).

(d) In connection with the Granite Canal development, Hydro has issued an irrevocable Letter of Credit, in the amount of $5.4 million to ensure compliance with the terms of the Fish Habitat Compensation Agreement between Hydro and the Department of Fisheries and Oceans.

12. COMPARATIVE FIGURES

Certain of the 2002 comparative figures have been reclassified to conform with the 2003 financial statement presentation.

Financial Statistics

Years ended December 31 (millions of dollars)	**2003**	2002	2001 [2]	2000	1999 [1]
OPERATING RESULTS					
Revenue					
Energy sales	**407.8**	399.6	374.8	357.0	384.4
Rentals and royalties	**0.3**	0.3	0.3	0.3	0.4
Recovery of costs in RSP	**16.7**	14.0	11.2	13.9	15.4
Guaranteed winter availability	**11.9**	9.5	7.5	4.6	3.6
Other	**4.8**	4.2	3.3	3.9	2.4
	441.5	427.6	397.1	379.7	406.2
Expenses					
Operations and administration	**125.8**	125.8	119.1	119.4	112.3
Amortization of RSP costs	**16.7**	14.0	11.2	13.9	15.4
Fuels and power purchased	**110.7**	89.0	65.8	58.3	48.2
Depreciation	**45.0**	43.0	44.5	47.7	51.3
Interest	**99.3**	97.8	102.5	105.5	107.6
	397.5	369.6	343.1	344.8	334.8
Income before unusual items	**44.0**	58.0	54.0	34.9	71.4
Write down of capital assets	**130.9**	-	-	-	16.7
Net income (loss) before non-controlling interest	**(86.9)**	58.0	54.0	34.9	54.7
Non-controlling interest	**(12.3)**	-	-	-	3.1
Net income (loss)	**(74.6)**	58.0	54.0	34.9	51.6
Contributions to net income (loss)					
Hydro Corporate	**18.1**	40.9	40.4	17.4	31.7
CF(L)Co.	**16.3**	17.1	13.6	17.5	19.9
GIPCo.	**(96.3)**	0.0	0.0	0.0	0.0
LCDC	**(12.7)**	0.0	0.0	0.0	0.0
FINANCIAL POSITION					
Total current assets	**143.1**	140.2	141.2	129.7	137.8
Total current liabilities	**271.1**	326.4	360.6	378.8	163.1
Net working capital	**(128.0)**	(186.2)	(219.4)	(249.1)	(25.3)
Capital assets	**2,573.5**	2,650.4	2,545.6	2,459.5	2,414.9
Accumulated depreciation	**780.5**	745.7	707.6	669.6	628.6
Capital assets, net	**1,793.0**	1,904.7	1,838.0	1,789.9	1,786.3
Sinking funds	**70.1**	48.7	42.7	35.4	28.8
Other assets	**225.1**	225.7	202.3	186.6	188.1
Long-term debt	**1,447.8**	1,354.9	1,156.7	1,043.3	1,226.4
Other liabilities	**34.5**	44.4	43.3	50.9	25.3
Shareholder's equity	**477.9**	593.6	663.6	668.6	726.2
STAFFING LEVELS AT YEAR END					
Full Time Equalivants (FTE) [3]	**1,190**	1,220	1,240	-	-

(1) Effective June 18, 1999, Hydro adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. (65.8%).

(2) Restated to reflect Churchill Falls' adoption of new recommendations of the Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses.

(3) Hydro has adopted the full time equivalent (FTE) method of reporting its staffing levels. Data on an FTE basis is not available prior to 2001.

Operating Statistics

Years ended December 31	**2003**	2002	2001	2000	1999
INSTALLED GENERATING CAPACITY (rated MW)					
CF(L)Co.	**5,428**	5,428	5,428	5,428	5,428
Twin Falls	**225**	225	225	225	225
Hydro					
Hydraulic	**939**	899	899	899	899
Thermal	**640**	640	640	640	645
Diesel	**57**	57	58	58	58
Total	**7,289**	7,249	7,250	7,250	7,255
ELECTRIC ENERGY GENERATED, NET (GWh)					
CF(L)Co.	**33,457**	35,516	32,910	35,143	34,508
Hydro					
Hydraulic	**4,321**	3,986	3,959	5,016	4,801
Thermal	**1,950**	2,380	2,095	966	914
Diesel	**49**	48	46	43	41
Total	**39,777**	41,930	39,010	41,169	40,264
ELECTRIC ENERGY SALES (GWh)					
CF(L)Co.					
Export	**28,647**	30,782	28,159	30,268	29,674
Hydro					
Utility	**4,642**	4,589	4,423	4,263	4,084
Rural	**878**	894	832	842	830
Industrial	**1,711**	1,675	1,528	1,607	1,343
Export	**1,439**	1,481	1,558	1,494	1,731
Total	**37,317**	39,421	36,500	38,474	37,662
AVERAGE RATE (cents per kWh)					
CF(L)Co.					
Export	**0.25**	0.25	0.27	0.27	0.27
Hydro					
Utility	**4.79**	4.60	4.50	4.49	4.49
Rural	**5.68**	5.59	5.60	5.53	5.54
Industrial	**3.14**	3.08	3.14	2.85	3.58
Export	**2.27**	2.27	2.22	2.22	2.22
TRANSMISSION LINES (km)					
CF(L)Co.					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,608**	1,533	1,534	1,536	1,536
138 kV	**1,500**	1,533	1,533	1,533	1,533
69 kV	**589**	586	587	586	586
Total	**4,736**	4,691	4,693	4,694	4,694
PEAK DEMAND (MW)					
CF(L)Co. System	**5,615**	5,587	5,637	5,606	5,590
Hydro System	**1,402**	1,403	1,262	1,240	1,265

Executive Management

Left to right: Fred Martin, John Roberts, Bill Wells, Jim Haynes, Maureen Greene

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Mark G.S. Bradbury
Treasurer

Peter A. Hickman
Assistant Corporate Secretary

INVESTING IN OUR COMMUNITIES

Newfoundland and Labrador Hydro is an integral part of this Province. As a Crown Corporation, we work hard to maintain a strong presence in communities throughout Newfoundland and Labrador. We believe that contributing to worthwhile causes enriches community life and that a prospering community creates, in turn, a positive climate for everyone.

In 2003, Hydro supported over 50 organizations in their efforts to improve the quality of life for Newfoundlanders and Labradorians including: the Arthritis Society, Dr. H. Bliss Murphy Cancer Centre, Captain William Jackman Memorial Hospital, Central Newfoundland Regional Health Centre, Cerebral Palsy Association of Newfoundland, Epilepsy Newfoundland and Labrador, General Hospital Health Foundation, Grenfell Regional Health Services, Health Labrador Corporation, Heart and Stroke Foundation of Newfoundland and Labrador, Janeway Children's Hospital Foundation, Autism Society of Newfoundland and Labrador, Canadian National Institute for the Blind, School Lunch Association, Canadian Red Cross – Badger Relief Fund, Community Food Sharing Association, Seniors Resource Center, Newfoundland Symphony Youth Choir and AIDS Newfoundland and Labrador.

Glossary of Terms

Cogeneration
The simultaneous generation of electricity and useful heat or steam. The heat could be put to use in an industrial process or to heat a facility or community. The electricity could be used by the owner or sold.

Demand
The rate at which electric energy is delivered at a given instant or averaged over a period of time. It is measured in kilowatts, megawatts, etc.

Distribution
Process of moving electric energy at lower voltages from major substations to customers.

Electrical Energy
The quantity of electricity delivered over a period of time. The commonly used unit of electrical energy is the kilowatt hour (KWh).

Electrical Power
The rate of delivery of electrical energy and the most frequently used measure of capacity. The basic unit is the kilowatt (KW).

Frequency
The number of cycles through which an alternating current passes in a second. The North American standard is 60 cycles per second, known as 60 hertz.

Gigawatt Hour (GWh)
A unit of bulk energy; 1,000,000 kilowatt hours.

Installed Generating Capacity
The rated load that can be supplied by a generating unit, power station or an entire provincial grid system.

ISO14001
A family of environmental management standards developed by the International Organization for Standardization.

Kilovolt (kV)
A unit of pressure, or push, of an electric current; 1,000 volts.

Kilowatt Hour (kWh)
A unit of bulk energy; 1,000 watt hours. The measurement is generally used for billing residential customers.

Load
The amount of electric power or energy consumed by a particular customer or group of customers.

Megawatt (MW)
A unit of bulk power; 1,000 kilowatts. The unit generally used to describe the output of a commercial generator.

Megawatt Hour (MWh)
A unit of bulk energy; 1,000 kilowatt hours.

Mills
1/10 of one cent or 1/1000 of one dollar.

Peak Demand
The maximum amount of electric power consumed by a particular customer or group of customers at a precise time.

Power System
All the interconnected facilities of an electrical utility. A power system includes all the generation, transmission, distribution, transformation, and protective components necessary to provide service to the customers.

Safety Frequency Rate
The number of work-related injuries or illnesses that result in lost work time during the year.

System Average Interruption Duration Index (SAIDI)
The average service interruption length in hours from a customer's point of view. This is used to track the performance in responding to outages. The target is based on historical performance.

System Average Interruption Frequency Index (SAIFI)
The average service interruption frequency from a customer's point of view. This is used to track the overall performance of Hydro's distribution system. The target is based on historical performance.

Substation
A distribution centre principally used for stepping up or stepping down the voltage through transformers.

Terawatt Hours (TWh)
A unit of bulk energy; 1,000,000,000 kilowatt hours.

Transformer
A device that raises or lowers voltages.

Transmission
Process of moving electric power in bulk at higher voltages through the system.

Voltage
The electrical force or potential that causes a current to flow in a circuit (just as pressure causes water to flow in a pipe). Voltage is measured in volts (V) or kilovolts (kv). 1 kV = 1000 V

Watt
The scientific unit of electric power. A typical light bulb is rated 25, 40, 60 or 100 watts, meaning that it consumes that amount of power when illuminated.

2003 Installed Generating Capacity

Megawatts (MW)

THE HYDRO GROUP

CF(L)Co.

LABRADOR

Interconnected

Hydraulic	
Churchill Falls	5,428

HYDRO

LABRADOR

Interconnected

Thermal (Diesel)	
Happy Valley-Goose Bay	11.7
Mud Lake	0.2
Thermal (Gas Turbine)	
Happy Valley-Goose Bay	27.0

Rural Isolated

Thermal (Diesel)	
16 Sites	22.9
Black Tickle	
Cartwright	
Charlottetown	
Davis Inlet	
Hopedale	
L'Anse-au-Loup	
Makkovik	
Mary's Harbour	
Nain	
Norman Bay	
Paradise River	
Port Hope Simpson	
Postville	
Rigolet	
St. Lewis	
Williams Harbour	

ISLAND

Interconnected

Hydraulic	
Bay D' Espoir	604
Cat Arm	127
Upper Salmon	84
Granite Canal	40
Hinds Lake	75
Paradise River	8
Snooks Arm/ Venams Bight	1
Roddickton	0.4
Thermal (Oil)	
Holyrood	490
Thermal (Gas Turbine)	
Hardwoods	54
Stephenville	54
Holyrood	15
Thermal (Diesel)	
Hawke's Bay	5
Roddickton	1.7
St. Anthony	8

Rural Isolated

Thermal (Diesel)	
7 Sites	7.4
François	
Grey River	
Little Bay Islands	
McCallum	
Ramea	
Rencontre East	
St. Brendan's	

LEGEND

- Generating Station
- Terminal Station
- Diesel Plant

Transmission Lines

- 735-kV
- 138-kV
- Low Voltage
- 230-kV
- 69-kV
- Customer-Owned

2003 GROSS ISLAND INTERCONNECTED ENERGY SUPPLY

Gigawatt hours (GWh)

Hydraulic Generation	
Bay D' Espoir	2,505
Cat Arm	818
Upper Salmon	520
Hinds Lake	341
Granite Canal	116
Paradise River	32
Mini Hydro	5
	4,337
Percentage of Total Energy Supply	65%

Power Purchases	295
Percentage of Total Energy Supply	4%
Thermal Generation	
Holyrood	2,061
Gas Turbine and Diesel	2
	2,063
Percentage of Total Energy Supply	31%

Newfoundland and Labrador Hydro
500 Columbus Drive, P.O. Box 12400
St. John's, Newfoundland and Labrador
Canada A1B 4K7

Energy. Generated for you.

Newfoundland and Labrador Hydro

2004 Annual Report

HYDRO
THE POWER OF COMMITMENT

2004 Annual Report

MISSION

Newfoundland and Labrador 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.

Our skilled and committed employees will use innovative methods and technologies, and will maintain high standards of safety and health, and environmental responsibility.

VISION

To be recognized as an innovative provider of quality energy services.

VALUES

The fundamental truths and principles practiced by Hydro and its employees in providing quality service to all its customers and stakeholders:

Integrity – Trust, respect, honesty and fairness are essential in our daily interactions with all individuals and stakeholders.

Responsibility – We value actions that are ethically, environmentally and socially responsible.

Teamwork – We promote safety and health, cooperation and openness in a supportive work environment.

Competence – We encourage and support innovation, continual improvement and learning, and the sharing of our knowledge and experiences.

Accountability – We accept responsibility for our individual and collective actions and performance.

Positive Attitude – We value enthusiasm and pride in our work.

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Head Office

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Cover Photo: (L-R) Wayne Snow, Terry LeDrew, Christine Stratton and Cecil Dyke

This paper contains 50% recycled content including 15% post consumer waste. It is acid free and chlorine free.

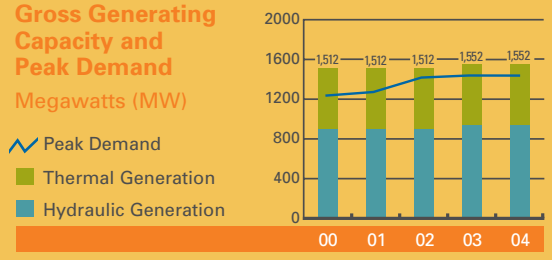
Hydro's employees are dedicated to improving our business to provide Newfoundlanders and Labradorians with least cost, reliable power.

Tom Hawco, Paul Patey, Russ Finlay and Sam Rose are working hands-on with their colleagues across the province to ensure service and process excellence in all they do.

Highlights

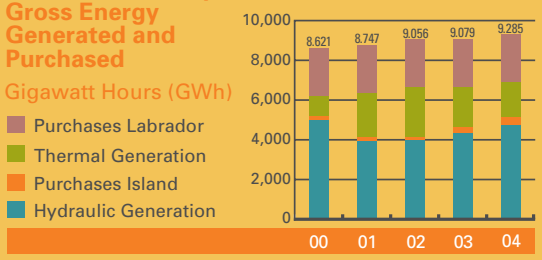
Island Interconnected Systems Gross Generating Capacity and Peak Demand

Megawatts (MW)



Interconnected Systems Gross Energy Generated and Purchased

Gigawatt Hours (GWh)



Message From the Chair

The next few years will be full of opportunity and excitement for Newfoundland and Labrador Hydro. The Corporation is entering a new era with renewed enthusiasm. I would like to welcome new members of the Board of Directors and thank those outgoing members for their contribution. I am pleased to return to Hydro at this time of transition and I know that the dedication and expertise of the Board and the executive management team will assist us as we move forward.

"In 2004, the Corporation celebrated 50 years since taking the first steps in the electrification of Newfoundland and Labrador. We intend to build on this history for a strong future. As the province's major energy provider Hydro is a valuable asset to the people, and with a new and expanded mandate, opportunities abound."

– Dean MacDonald

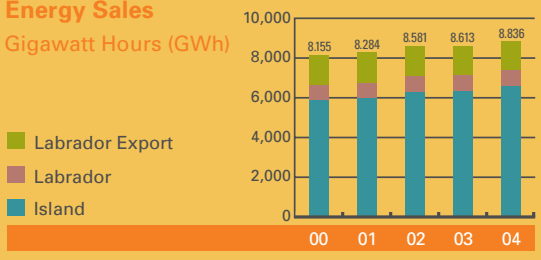
Hydro has a strong foundation and a proud history. In 2004, the Corporation celebrated 50 years since taking the first steps in the electrification of Newfoundland and Labrador. We intend to build on this history for a strong future. As the province's major energy provider Hydro is a valuable asset to the people who live here, and with a new and expanded mandate, opportunities abound. We will work with our government shareholder to further define this mandate in 2005.

This past year is marked by several significant successes from corporate ISO 14001 certification to improved fiscal performance. With the incorporation of rate adjustments in 2004, regulated activities returned to profitability this past year, and overall net income before unusual items rose from $23.2 million in 2003 to $67.2 million in 2004. Performance gains were also reflected in other key areas such as lower controllable unit costs and increased system reliability.

Highlights

Interconnected Systems Energy Sales

Gigawatt Hours (GWh)



"Hydro has demonstrated a proven track record in making a positive contribution to this province and its people. Leveraging on the skills and capabilities within Hydro, the Corporation is in a position to make an even greater contribution to its owners – the people of Newfoundland and Labrador."

– William Wells

Message From the Chair

I would like to thank outgoing President and CEO Bill Wells for his enduring commitment and achievements during more than nine years at the helm of Hydro. He has seen the Corporation through significant internal and external realignment based on sound strategic planning, all the while maintaining a passionate outlook on the future of Hydro. On behalf of all Board members I extend my wishes for a happy and healthy retirement.

Hydro continues to take great strides in productivity improvements and I would like to commend executive management and all employees for the steps they take to ensure that we are fulfilling the mandate of the Corporation of providing least cost, reliable power to consumers in Newfoundland and Labrador.

Dean MacDonald
Chair of the Board

Chair, Dean MacDonald

From the President

Fifty years ago, the first steps leading to the creation of Hydro were taken, resulting in profound change affecting the lives of Newfoundlanders and Labradorians. As the province's major energy provider, Hydro has become an integral part of every day life in every corner of the province. Change has been a constant throughout the past fifty years, and Hydro is now on the threshold of even more significant change as new horizons beckon.

In keeping with its mandate, Hydro has delivered energy to consumers at very competitive rates and provided a return to our government shareholder for the benefit of all citizens. 2004 was no exception; we had an excellent year. Our indicators for reliability, safety and cost containment were very positive. Our operations annually are now approaching the half billion-dollar mark, our net income was $67.2 million, and the dividend payout to the province was $50.6 million. Hydro's export sales were $44.1 million.

CHURCHILL FALLS LABRADOR CORPORATION (CF(L)Co)

In 2007, the principal debt of CF(L)Co's First Mortgage bonds will be retired. A final payment of $55 million in 2010 will retire the remaining debt. The return from the Guaranteed Winter Availability Contract, which was $22.2 million in 2004, strengthens the financial capability of CF(L)Co. In addition to debt retirement, we will be able to build a substantial cash reserve by 2012 to ensure the sustainability of the operation. Reinvesting in CF(L)Co to ensure that future generations will have the benefit of this great resource is an important element in the good management of the facility. An enhanced dyke maintenance program introduced in 2004 and the ongoing replacement of the SCADA system are reflective of our commitment to the proper maintenance and operation of this world-class plant.

RATES

New energy supplies come at a cost. In May 2004, we received the decision on our rate application filed in 2003 with the Board of Commissioners of Public Utilities, which resulted in a 9.3 per cent increase in base rates to our largest customer, Newfoundland Power. Increases to electricity consumers were, on average, 5.4 per cent and 9.6 per cent to our industrial customers. The increased costs, reflected in rates, were necessary to cover new generation brought on-stream in 2003 to meet increasing demand on the Island Interconnected System, rising fuel costs, depreciation and to provide a margin for the Corporation. Despite this, our rates are still very competitive.

CHALLENGES

While the challenges of the past have been dealt with, Hydro will confront serious issues in the future. There are huge obstacles to be overcome in the electricity sector in North America, and indeed throughout the world, to provide environmentally acceptable and reliable energy at reasonable cost. Electricity consumers in this province are not immune to these issues as the real cost of energy will become a significant factor in our marketplace. It will become more evident to consumers that energy is an essential commodity that cannot be taken for granted. In addition to environmental stewardship, the need for conservation will become clearer to consumers in reaction to the ultimate signal – price.

Annually, the Holyrood Thermal Generating Station can generate up to 40 per cent of the energy required for the Island Interconnected System. Despite past investments in environmental monitoring programs and operational controls to ensure continual improvement in emissions, the plant presents some very important strategic issues that must be addressed. There are no short-term, economic displacement options for the

Holyrood plant since it is critical to meeting the needs of electricity consumers on the island. The plant is classified, under the Climate Change Plan for Canada, as a Large Final Emitter. As a result, options for increased emissions control are being investigated and recommendations will be made in 2005. With the implementation of the Kyoto Protocol, Hydro also will have to reduce greenhouse gas emissions and additional costs will be incurred. The life expectancy of the plant and the potential to convert from No. 6 fuel to gas must also be considered. Making the right decisions will involve a complex balance of environmental and economic priorities to ensure that all stakeholder interests are addressed.

ACCOMPLISHMENTS

One of our key corporate objectives in 2004 was that all Hydro divisions would achieve ISO 14001 certification, including production facilities, transmission and rural operations, as well as corporate services. In May, we celebrated this major accomplishment with employees across the company. Our Environmental Management System provides us with a solid framework for environmental management and continuous improvement. We are committed to managing our operations to reduce our environmental impact, while balancing our mandate to provide our customers with cost-effective and reliable power.

Our environmental efforts were also recognized with the Environment Award from the Professional Engineers and Geoscientists of Newfoundland and Labrador for the Granite Canal Hydroelectric Development. Hydro embarked on a landmark environmental management program including the development of a 45,000 m^2 Fish Habitat Compensation Facility. This project is becoming recognized across North America for its innovation.

President and CEO, William E. Wells

INVESTMENTS

Capital investment is expected to intensify over the coming years as Hydro grapples with an aging system and meets increasing expectations for reliable service. Many of our assets are approaching 40 years of service. This balance is one of many that Hydro works through in our strategic approach to the provincial electrical system and our business.

To ensure system reliability, this past year Hydro invested $40 million in capital for infrastructure upgrades. Over four million dollars was invested to upgrade transmission lines on the West Coast of the province that are subject to severe weather conditions. These upgrades will contribute to improved reliability to customers in the area. This was a significant project

that involved teams of employees from various regions and disciplines who came together to complete the work well ahead of schedule, with minimal outage time through coordination with Newfoundland Power. The project is a reflection of the immense skill and talent of our employees. Quite frankly, no one does it better and we are proud of their accomplishments.

PERFORMANCE

As a Crown Corporation we are focused on delivering value to our government shareholder and our customers. Our employees have demonstrated their commitment to service excellence and they continue to work diligently to deliver cost-effective and reliable service. Employees are dedicated to the process of business improvement and the Corporation is leveraging its expertise, in concert with industry best practices, to improve performance and it shows. This year we have achieved improvements in reliability, safety and a continued reduction in one of our key performance and productivity indicators, controllable unit costs, which continued to decrease from $13.57 in 2000 to $11.97 in 2004.

In 2004, the government announced plans to expand the Corporation's mandate providing potential for new challenges and opportunities. Hydro has demonstrated a proven track record in making a positive contribution to this province and its people. Leveraging on the skills and capabilities within Hydro, the Corporation is in a position to make an even greater contribution to its owners – the people of Newfoundland and Labrador.

I am grateful to the Board of Directors of Hydro and CF(L)Co for their support and direction through 2004. It was a year of transition and I would like to thank outgoing members for their contribution and service. In September 2004, I announced my retirement pending recruitment of a new President and Chief Executive Officer. I would like to take this opportunity to express my gratitude to Board members, my colleagues in management and all employees and business associates throughout the industry with whom I have had the pleasure to work for the past nine years.

Our accomplishments are noted throughout the pages of this annual report and they are the accomplishments of our employees across the province. They come to work every day ready to fulfill the mandate of the Corporation – providing least cost, reliable power – for their fellow Newfoundlanders and Labradorians.

William E. Wells
President and Chief Executive Officer

Hydro has gas turbine systems in place to ensure a reliable supply of power to meet the annual peak demand.

Wayne Snow keeps the Hardwoods Gas Turbine in tip top shape and ready to supplement the power supply to the Northeast Avalon.

2004 In Review

ABOUT NEWFOUNDLAND AND LABRADOR HYDRO

Newfoundland and Labrador Hydro (Hydro), is a Crown Corporation, owned by the province of Newfoundland and Labrador. Hydro is the parent company of the Hydro Group of Companies (Hydro Group) comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation Limited (LCDC), Gull Island Power Company Limited (GIPCo) and Twin Falls Power Corporation Limited (TwinCo).

Founded in 1954 as the Newfoundland Power Commission, with a mandate to promote rural electrification, Hydro was established as a Crown Corporation in 1975 and is currently governed by the Hydro Corporation Act and the Electrical Power Control Act. Hydro has a mandate to deliver reliable, least cost energy to residents and industry in Newfoundland and Labrador.

The Hydro Group's installed generating capacity, 7,289 megawatts (MW) is the fourth largest of all utility companies in Canada. Our power generating assets include one oil-fired plant, four gas turbines, 27 diesel plants and 10 operating hydroelectric plants, including the Churchill Falls Hydroelectric Generating Station which is the largest underground powerhouse in the world with a rated capacity of 5,428 MW. Hydro also maintains over 4,700 km of transmission lines and 3,600 km of lower voltage distribution lines.

With a dedicated workforce of 1,149 full-time equivalents, including CF(L)Co, Hydro is the province's major energy provider. Every year, Hydro generates and transmits over 80 per cent of the electrical energy consumed by Newfoundlanders and Labradorians – over 6,487 gigawatts hours (GWh) of energy in 2004. Hydro also distributes power directly to 35,000 customers in rural Newfoundland and Labrador, which represents about 15 per cent of the province's electrical consumers.

PERFORMANCE – DELIVERING ON OUR COMMITMENT TO CUSTOMERS

- Hydraulic production on the Island Interconnected System in 2004 was 4,743 GWh, up 9.34 per cent from 2003 due to the first full year of production from the Granite Canal Hydroelectric Development, which went into service in June 2003, and above average inflows to the Bay d'Espoir storage reservoirs. Inflows in 2004 were 7.6 per cent above the 55-year record average. Purchases of energy also increased by 40 per cent to 413 GWh, as a result of the first full year of production from two new non-utility generators.
- The combined increases in hydraulic generation and energy purchases, offset by a 3.3 per cent increase in energy supply requirements on the Island Interconnected system, resulted in a 15.37 per cent reduction in production from the Holyrood Thermal Generating Station to 1,744 GWh. This resulted in a reduction of No. 6 fuel oil consumption to 2,605,818 barrels. The plant provided 25 per cent of Hydro's energy supply in 2004.
- No. 6 fuel costs for Holyrood remained relatively stable with prices ranging from $29.94 to $33.87/bbl. The average price for 2004 was $31.02 compared with the cost in rates of $29.05.
- The Rate Stabilization Plan (RSP) balance at the end of 2004 was $137 million, down from $156 million at the end of 2003. The RSP balance is the difference between the cost of fuel consumed and the cost paid by customers in rates.
- Energy sales within the province reached a record level of 7,437 GWh, a 2.8 per cent increase over the record established in 2003. Growth in the Island Interconnected System was 3.4 per cent to 6,575 GWh driven by increased sales to Newfoundland Power and industrial customers. The Labrador Interconnected System was down 1.0 per cent to 805 GWh as a result of extended labour disputes at mining operations in Labrador West.
- In May 2004, Hydro received the decision on its General Rate Application from the Board of Commissioners of Public Utilities (PUB). The PUB approved a 9.3 per cent increase to Newfoundland Power; resulting in an average 5.4 per cent increase to consumers and 9.6 per cent to industrial customers effective July 1, 2004. The increases were necessary to cover the cost of new generation brought on stream in 2003, to meet increasing load growth on the Island Interconnected System, rising fuel costs, depreciation and Hydro's margin. Rates remain competitive with other Atlantic Canadian utilities.
- The PUB also approved a demand energy rate structure for Newfoundland Power, a five-year implementation plan for uniform rates in Wabush, Labrador City and Happy Valley-Goose Bay and changes in the RSP.
- In September, Hydro began purchasing power from the province's first wind-diesel demonstration project in Ramea, an isolated diesel community on the South Coast of the Island. Six 65 kV turbines are installed and capable of providing 35 per cent of the required capacity for the community. Current production estimates show that Hydro can offset 190,000 litres of fuel annually with wind purchases under this power purchase agreement.
- Hydro has invested steadily in our core transmission systems to ensure reliable service and 2004 was an excellent year. Bulk System Performance indicators, SAIFI and SAIDI averages improved over 2003. This past year there were 30 per cent fewer delivery point outages, 60 per cent fewer outage hours and 40 per cent fewer hours per interruption.
- Productivity and management of controllable costs continued to be a focus in 2004. Controllable unit costs, a measure of the controllable operations and administrative costs spent for each megawatt hour delivered, decreased for the fifth consecutive year from $12.42/MWh in 2003 to $11.97/MWh in 2004.

2004 In Review

OUR PEOPLE – GENERATING ENERGY FOR YOU

- Safety is paramount at Hydro and 2004 was a record year. Hydro employees achieved their best performance in the past five years with an all injury frequency rate of 1.43, a 32 per cent decrease from 2003. The total number of accidents declined this year from 17 to 11.
- Hydro continues to promote safety awareness to its employees and this year employees participated in Safety and Health Week events throughout the company. This year's theme was, "Build a Safe Beginning" and activities were aligned with North America's Occupational Safety and Health Week.
- Hydro continues to invest in employee health and wellness. Wellness Works, launched in 2003, promoted the well-being of employees through the appointment of regional wellness representatives and initiatives such as Stairway to Health, celebrating Canada's Healthy Workplace Week and several other projects.
- Training and development is a core component of Hydro's success. In 2004, over 700 Hydro employees participated in training and skills upgrading from trades and technical training to leadership and information technology.
- 38 employees retired in 2004 and 120 are eligible for retirement in 2005. Hydro continues to focus on the training and development of our current employees, as well as recruitment and retention.
- Hydro administers one of the top apprenticeship programs in the province. We work with the Department of Education and the College of the North Atlantic to provide practical work experience in conjunction with in-school and academic training to many apprenticeship crafts. In 2004, the Hydro Group employed 44 apprentices from line workers to industrial mechanics and hydro plant operators. The program is a critical and strategic element in Hydro's recruitment strategy and demonstrates our support for locally trained and skilled workers.

OUR CUSTOMERS – THE CORE OF OUR BUSINESS

- Hydro's Customer Satisfaction Survey showed that Hydro has once again matched the national Canadian Electricity Association average with a Customer Service Index of 7.9. Overall, 93 per cent of our customers are satisfied with the level of customer service they receive from Hydro.
- Hydro launched its new customer newsletter, "Watts New" in June. This quarterly publication is distributed to all Hydro customers and contains information on customer programs, reliability initiatives and a means to give feedback to Hydro on an ongoing basis.
- Hydro continues to develop tools associated with the Hydrowise energy awareness program. This year, two new brochures were developed on Draft Sealing and Compact Florescent Lighting. Visit: www.hydrowise.ca.
- As part of the Hydrowise conservation program, Hydro started distributing 16,000 compact fluorescent lights (CFL) to residential customers on diesel systems. Each customer received a coupon for six CFLs. Once all CFLs are in use, this initiative has the potential to save Hydro about 1.2 GWh per year, which equates to 363,000 litres of fuel annually. Customers can expect bill savings averaging about $5 per month.
- Through Hydrowise, Hydro joined the national Switch and Save campaign in early October. The program encourages homeowners to switch their incandescent lights to compact florescent lights.

INVESTING IN OUR SYSTEMS FOR IMPROVED RELIABILITY AND SERVICE FOR CUSTOMERS

- In 2004, Hydro invested over $40 million in strategic capital programs across the province to ensure enhanced reliability and improved service to customers. Over the past five years Hydro has invested over $365 million in the provincial electrical system.
- Hydro upgraded transmission line 214 on the West Coast of the province which is subject to severe weather conditions. This $3.9 million project will result in improved service and reliability to Newfoundland Power customers in the Port aux Basques-Codroy Valley area. This upgrade involved the replacement of 23 structures and over 10,000 insulators including state-of-the-art fog insulators.
- Hydro started the first phase of the replacement of its obsolete Distributed Control System at the Holyrood Thermal Generating Station in 2004. This $2.6 million project will be completed in 2006 and will ensure that plant availability and reliability are maintained.
- Hydro also began the replacement of its Energy Management System (EMS). This multi-million dollar project is expected to be completed in 2006. The EMS, a critical system, is responsible for control, monitoring and dispatch of transmission and generation assets and related water resources across the province.
- The L'Anse au Loup distribution system had several extended outages during the winter of 2003-2004. Hydro conducted a system inspection and identified key areas of concern. The Corporation invested almost $230,000 in distribution system upgrades in 2004 to enhance performance to customers and work will continue in 2005 with a further investment of over $1 million including generation capacity additions.
- Hydro operates 2,500 km of wood pole transmission lines at various voltages with over 26,000 transmission poles. Many of these poles are over 30 years old and are reaching the end of their useful life. Hydro has engaged in a proactive Wood Pole Management Program, which focuses on the inspection, testing and treatment of wooden transmission structures and ensures that any reliability and safety concerns are highlighted and corrected. The program is expected to extend the life of these assets by at least 10 years.
- Extensive upgrading was completed at the Happy Valley Terminal Station (HVTS) last year. The HVTS receives power via a 138 kV transmission line from Churchill Falls and has a 26 MW gas turbine used primarily for voltage support and emergency power. With peak load reaching the capacity of the existing transformers at the station, this upgrading has enabled the transmission of more power to the Happy Valley, North West River and Sheshashiu distribution system from Churchill Falls. This upgrading will satisfy the power needs for the foreseeable future and will result in fewer outages to communities during maintenance.
- Hydro invested more than $6 million to improve distribution systems and provide service to new customers. For example, the Corporation upgraded and replaced 243 deteriorated poles on the Bottom Waters and St. Anthony systems.

2004 In Review

ENVIRONMENT AND CONSERVATION

- In 2004, all Hydro divisions achieved ISO 14001 certification including production facilities, transmission and rural operations, as well as corporate services. This was a major accomplishment for the Corporation and our employees. Our Environmental Management System provides us with a solid framework for environmental management and continuous improvement. We are committed to managing our operations to reduce our environmental impact, while balancing our mandate to provide our customers with cost-effective and reliable power.
- Hydro was awarded the Professional Engineers and Geoscientists of Newfoundland and Labrador's 2004 Environmental Award for the Granite Canal Fish Habitat Compensation Facility. The award recognizes the application of science, technology and engineering to human and resource environmental management.
- The revegetation of the banks along the Fish Habitat Compensation Facility at Granite Canal began in August. Over 3000 native plants – 14 different species – were planted. Hydro partnered with Memorial University of Newfoundland Botanical Gardens for this project. They assisted in the revegetation and provided weather hardened and native plants collected at the site during the spring of this past year.
- Four permanent ambient air monitoring stations in the Holyrood area were upgraded to include monitoring of nitrous oxide and fine particulate. Attention has been focused on monitoring and quantifying emissions with a view to reducing the environmental impact. These stations, along with other state-of-the-art monitoring equipment, measure emissions at the source and in the surrounding area.
- Work began to update the 1999 Cantox Air Emissions Human Health Risk Assessment in Holyrood. Over 110 local residents attended two public open houses held in Holyrood and Conception Bay South in September. Results from the study are expected in spring 2005.
- Hydro continued to communicate with area residents through the Community Liaison Committee (CLC). The CLC met six times last year and was expanded to include a community representative. The CLC also played an instrumental role in the Cantox Air Emissions study and provides Hydro with ongoing feedback from the community.
- Hydro continues to provide proper training and awareness on environmental management to its employees. In 2004, 111 employees attended environmental training sessions and some employees received training on basic soils and water-sampling techniques associated with spill response clean-ups.
- Work on the Great Northern Peninsula during the summer uncovered areas containing calcified limestone barrens habitat that contained a number of rare and endangered plant species. Line crews were preparing to install 69 new poles along the distribution line to Boat Harbour from Cooks Harbour in Pistolet Bay, south of St. Anthony when the plants were discovered. Hydro's environment department studied the plants, listed as endangered in accordance with the Committee on the Status of Endangered Wildlife in Canada, as well as other species that are considered rare for the province. A full environmental awareness session was held with workers and work in the area continued under the risk legislation.
- Hydro once again sponsored a Conservation Corp Green Team that began the second year of a study on the limestone barrens near Port aux Choix. The Hydro/Limestone Barrens Habitat Stewardship Program Green Team focused on community education of the flora that spans the West Coast of the Great Northern Peninsula. The goal was to engage the community in protecting the flora and conserving the habitat.

Corporate headquarters in St. John's houses a variety of disciplines serving the Hydro Group of Companies.

Christine Stratton, Trent Carter and Tom Peckford keep a global eye on finance, environmental issues and employee assistance from Hydro Place.

Management's Discussion and Analysis

Management's Discussion and Analysis highlights the primary factors that have an impact on the financial results and operations of the Corporation. It should be read in conjunction with the audited financial statements and the accompanying notes.

Newfoundland and Labrador Hydro (Hydro) is a Crown Corporation, owned by the Province of Newfoundland and Labrador (Province). Hydro generates, transmits and distributes electrical power and energy to utility, residential and industrial customers throughout the province.

Hydro is the parent company of the Hydro Group of Companies (Hydro Group) comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation Limited (LCDC), Gull Island Power Company Limited (GIPCo), and Twin Falls Power Corporation Limited (TwinCo). The Hydro Group's installed generating capacity is the fourth largest of all utility companies in Canada. Our power generating assets consist of 10 operating hydroelectric plants, including the Churchill Falls hydraulic plant, which is the largest underground powerhouse in the world with a rated capacity of 5,428 megawatts (MW) of power, one oil-fired plant, four gas turbines and 27 diesel plants.

FINANCIAL OVERVIEW

Net income for 2004 increased by $141.8 million compared to 2003, which reflected the 2003 write-down of $118.6 million in project costs and capital studies related to potential hydro-electric developments in Labrador.

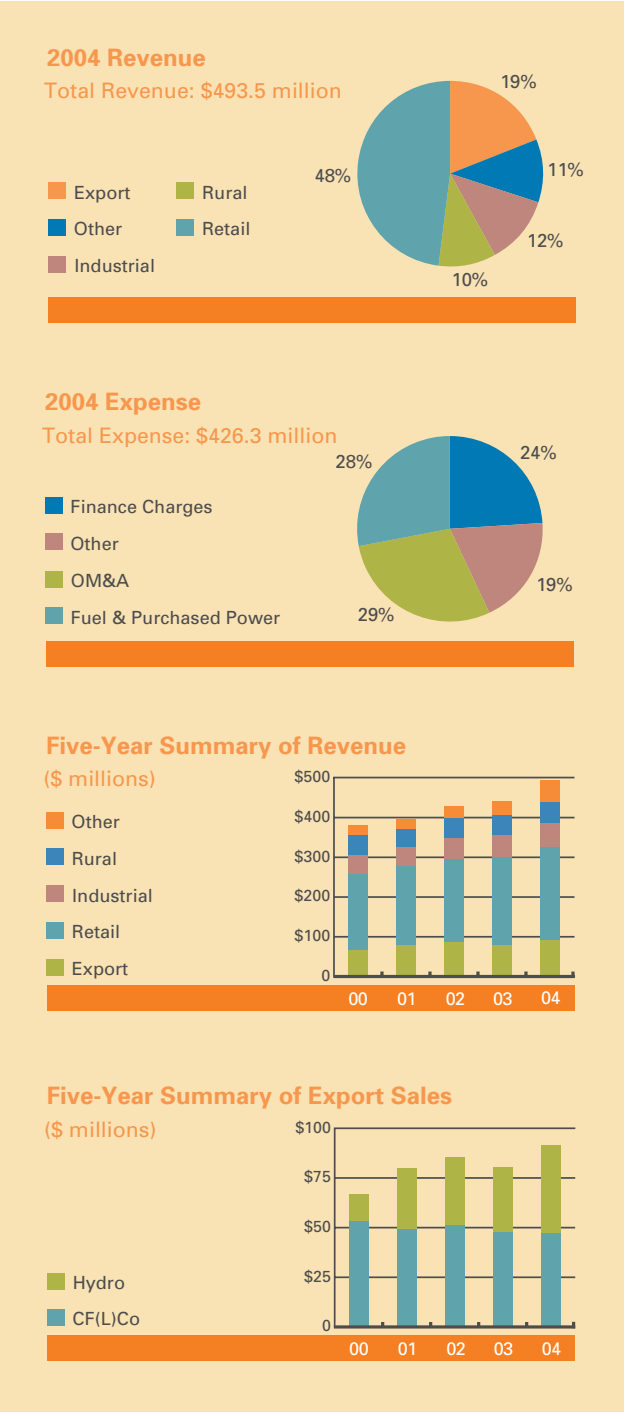
In comparison to the 2003 results before unusual write-downs, net income was up 53% mainly due to higher revenues in 2004, partially offset by higher power purchased costs.

The Hydro Group has a workforce of approximately 1,149 full time equivalents, a reduction of 3% compared to 2003.

COMPOSITION OF REVENUE AND EXPENSE

Hydro's revenue consists of sales of electricity to several large industrial customers in the Province and over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Hydro also supplies 90% of the energy required by Newfoundland Power, an investor-owned utility that distributes electrical power to the balance of the population on the island portion of the province. Export sales consist of power generated at Churchill Falls and sold to Hydro-Québec. The majority of these sales are made directly by CF(L)Co to Hydro-Québec at rates set under a long-term power contract. The remainder is sold to Hydro-Québec by Hydro at negotiated rates.

The Corporation's major expense categories consist of fuel and purchased power, operating, maintenance and administration, finance charges and depreciation.



NET INCOME

Hydro's consolidated net income was $67.2 million in 2004, an increase of $23.2 million from 2003, before unusual items. Over the past five years, Hydro has paid $318.8 million in dividends to the Province.

REVENUE

Total revenue growth in 2004 was approximately 12% mainly due to continued load growth, a general rate increase to regulated customers approved by the Board of Commissioners of Public Utilities (PUB) effective July 1, 2004, and a new contract for sales of recall power to Hydro-Québec, effective April 1, 2004. Also contributing to higher revenue was additional compensation from the Guaranteed Winter Availability Contract between CF(L)Co and Hydro-Québec.

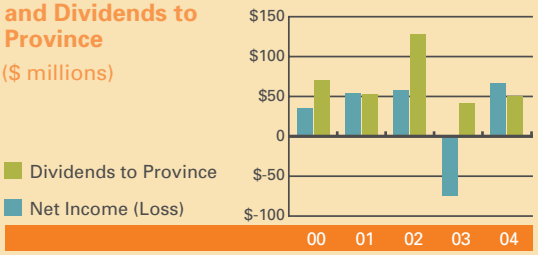
EXPENSES

Total expenses for 2004 were $28.8 million or 7% higher than 2003 primarily due to an increase of $17.5 million related to amortization of costs in the Rate Stabilization Plan (RSP) and an increase of $10.0 million in purchased power costs. The increase in purchased power costs is due to more energy supplied by two new non-utility generators that began in 2003.

Hydro pays various fees, taxes and other charges as indicated below.

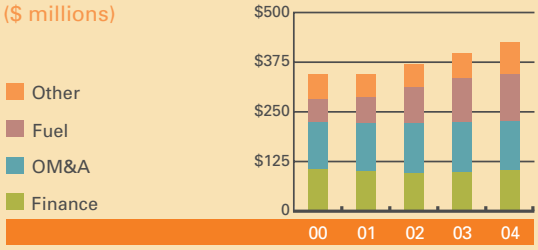
Five-Year Summary of Net Income (Loss) and Dividends to Province

($ millions)

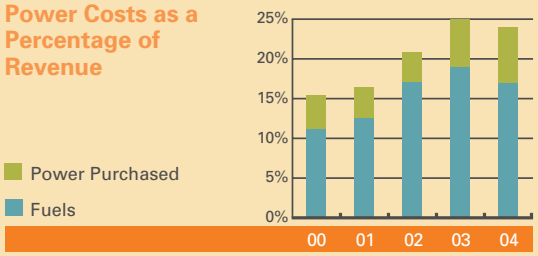


Five-Year Summary of Expense

($ millions)



Five-Year Summary of Fuel and Purchased Power Costs as a Percentage of Revenue



Fees, Taxes and Water Rentals (millions of dollars)		**2004**	2003
Payment	**Recipient**		
Debt Guarantee Fee	Government of Newfoundland and Labrador	**$ 14.6**	$ 13.9
Payroll Tax	Government of Newfoundland and Labrador	**1.4**	1.2
Rentals and Royalties	Government of Newfoundland and Labrador	**5.2**	4.8
Municipal Taxes	Various Newfoundland and Labrador Municipalities	**1.2**	1.3
Total		**$ 22.4**	$ 21.2

OPERATIONS, MAINTENANCE AND ADMINISTRATION

Overall, operations, maintenance and administration expenses were consistent with 2003.

In 2004, 25¢ out of every dollar in revenue went to pay for operations and administration expense. This is down from 28¢ in 2003.

Hydro continues to demonstrate an improving trend in controllable unit costs which is a measure of the number of controllable operations and administrative dollars spent for each megawatt hour of energy delivered.

FINANCE CHARGES

Interest expense including the guarantee fee increased by $4.4 million to $103.7 million, primarily due to lower interest earned and higher average debt outstanding. Finance charges, as a percentage of revenue, continue to decline.

CAPITAL EXPENDITURES

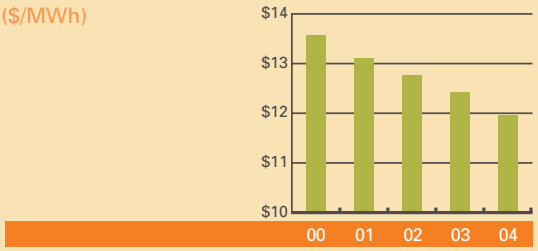
In order to ensure a safe, reliable and cost-effective supply of electricity for its customers, Hydro invested $40.1 million in various capital projects during 2004, compared to $67.3 million in 2003. Major capital investments in 2004 included:

- $4.0 million related to improvements at various hydraulic generation sites.
- $6.3 million related to the improvements to the Distribution System along with additions for new customers.
- $4.4 million related to the potential development of hydro projects in Labrador.
- $2.7 million for improvements at the Holyrood Thermal Generating Station.
- $5.3 million related to upgrades to Transmission Systems.

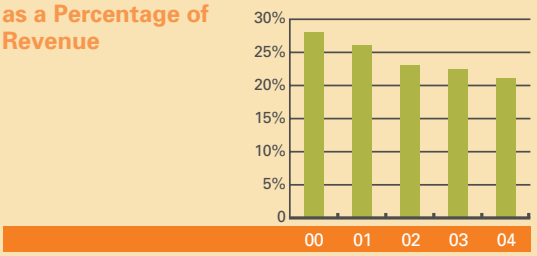
BORROWING AND DEBT

There were no new long-term borrowings during 2004. Hydro's net debt decreased to $1,521.2 million at December 31, 2004, from $1,558.2 million at December 31, 2003, as a result of scheduled principal repayments on long-term debt of $23.5 million, increased promissory notes outstanding of $8.0 million, and an investment in sinking funds of $21.6 million.

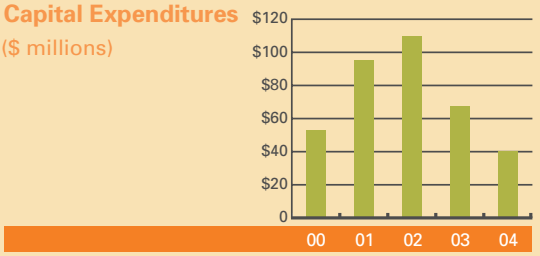
Controllable Unit Cost
($/MWh)



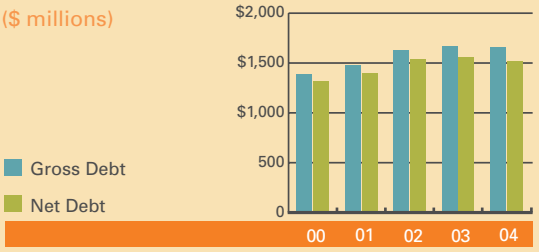
Five-Year Summary of Finance Charges as a Percentage of Revenue



Five-Year Summary of Capital Expenditures
($ millions)



Debt Outstanding at December 31
($ millions)



PERFORMANCE MEASURES

Hydro continues to focus on corporate performance by tracking progress against several key performance indicators. The financial measures below reflect Hydro's operating results only, exclusive of subsidiary activity.

Return on equity and the interest coverage ratio increased from 2003 primarily due to a higher net income arising from higher revenue partially offset by higher purchased power costs. The debt to capital ratio remains stable. Hydro continues to demonstrate an improving trend in controllable unit cost.

Financial Performance Indicators (Hydro only)	**2004**	2003	2002
Return on Equity (%)	**23.4**	8.6	15.9
Debt to Capital (%)	**86**	86	85
Interest Coverage Ratio	**1.39**	1.15	1.37
Controllable Unit Cost ($ / MWh)	**11.97**	12.42	12.77

Non-Financial Performance Indicators (Hydro only)	**2004**	2003	2002
Weighted Capability Factor	**89.76**	87.83	86.30
Thermal Conversion Factor (Holyrood)	**632.27**	634.92	648.49
SAIFI - Transmission	**1.84**	2.59	1.72
SAIFI - Distribution	**5.90**	7.86	9.44
SAIDI - Transmission	**98.77**	222.34	106.72
SAIDI - Distribution	**11.17**	11.90	13.63
All Injury Frequency Rate	**1.43**	2.10	1.98
Residential Customer Satisfaction Index	**7.9**	7.9	8.1
Commercial Customer Satisfaction Index	**8.1**	8.1	8.2

DESCRIPTION OF PERFORMANCE INDICATORS

RETURN ON EQUITY – Net Income/Average Equity.

DEBT TO CAPITAL – Year-end debt balance expressed as a percentage of the total corporate financing structure.

INTEREST COVERAGE RATIO – The extent to which income before financing charges is able to cover the corporation's interest obligations.

CONTROLLABLE UNIT COST – Controllable Corporate Operating, Maintenance and Administrative Cost / energy deliveries (MWh).

WEIGHTED CAPABILITY FACTOR – Percentage of time that units are available to supply load, weighted to reflect differences in unit size.

THERMAL CONVERSION FACTOR (HOLYROOD) – Net kWh generated/barrels of No. 6 fuel consumed.

SYSTEM AVERAGE INTERRUPTION FREQUENCY INDEX (SAIFI) – Total number of sustained outages/ total number of delivery points or customers. An outage is sustained if over one minute in duration. For transmission, denominator is delivery points; for distribution it is customers. This is used to track the overall performance of Hydro's transmission and distribution system.

SYSTEM AVERAGE INTERRUPTION DURATION INDEX (SAIDI) – Total duration (minutes) of all outages/number of delivery points or customers. For transmission, denominator is delivery points; for distribution, it is customers. This is used to track the performance in responding to outages.

ALL INJURY FREQUENCY RATE – [(# of disabling injuries + # of medical aid injuries) * 200,000] / hours worked. It measures the frequency with which injuries occur.

CUSTOMER SATISFACTION INDEX – The weighted average of satisfaction ratings of the service attributes, based on annual rural residential customer survey.

HYDRO SUBSIDIARIES

Hydro has one wholly owned subsidiary, GIPCo, as well as a 51% interest in LCDC and a 65.8% interest in CF(L)Co. CF(L)Co is accounted for as a joint venture and therefore only Hydro's proportionate share of its financial statement items appears below.

REGULATION

On May 4, 2004, the PUB issued its decision on Hydro's 2003 General Rate Application (GRA) with new rates becoming effective July 1, 2004. Hydro had filed its GRA in May 2003 seeking rate adjustments primarily resulting from the costs of new sources of supply required to meet the island's growing electricity needs. In 2003, three new power sources came in service: Hydro's 40 MW (224 GWh) Granite Canal project as well as two new non-utility generating sources. Hydro was granted increases in the base rates it charges Newfoundland Power as well as its island industrial customers. In its order, the PUB also approved a five-year phase-in of uniform rates on the Labrador Interconnected system commencing in 2004.

Amongst other issues during the hearing, Hydro requested a rate of Return On Equity (ROE) of 9.75% for the purpose of determining its cost of capital. If accepted by the PUB, this level of return would have given Hydro a market-based rate of return on equity. The PUB, in its decision, granted Hydro a 5.83% ROE which was equal to the Province's marginal cost of debt at that point in time.

On December 8, 2004, the PUB issued a subsequent order approving a demand-energy rate for Newfoundland Power. The demand-energy rate replaces the energy-only rate effective January 1, 2005, and will result in a more effective wholesale price signal, potentially conserving capital and natural resources.

Performance Indicators (Regulated Operations Only)	**2004**	2003	2002
Return on Rate Base (%)	**7.03%**	6.30%	7.25%
Return on Equity (%)	**3.52%**	(1.24%)	4.03%

millions of dollars	Hydro (Unconsolidated)	CF(L)Co	GIPCo	LCDC	Eliminating Entries	Hydro (Consolidated)
2004 Net Income						
Revenue	$ 427.2	$ 67.9	$ -	$ -	$ (1.6)	$ 493.5
Expenses	379.6	47.2	-	-	(0.5)	426.3
Net Income (loss)	$ 47.6	$ 20.7	$ -	$ -	$ (1.1)	$ 67.2
2004 Balance Sheet						
Total Assets	$ 2,131.8	$ 364.2	$ 0.1	$ 5.2	$ (270.2)	$ 2,231.1
Liabilities	$ 1,641.0	$ 97.1	$ -	$ -	$ 2.1	$ 1,740.2
Equity	490.8	267.1	0.1	5.2	(272.3)	490.9
Total Liabilities and Equity	$ 2,131.8	$ 364.2	$ 0.1	$ 5.2	$ (270.2)	$ 2,231.1

OUTLOOK FOR 2005

Earnings are expected to be higher in 2005 primarily due to an increase in export sales. Also, the total outstanding balances owing to Hydro from customers, primarily related to deferred fuel charges in the RSP, are forecast to decline to $99.5 million by the end of 2005.

RATE STABILIZATION PLAN (RSP)

The difference between the cost of fuel consumed and the cost upon which rates are based accumulates in the RSP. Balances which accumulated prior to December 31, 2003, are being recovered over a four-year period which commenced in 2004. As of December 31, 2004, $134.0 million remains to be recovered.

Subsequent balances accumulating in the RSP are recovered in the following year, with the exception of the hydraulic variation, which will be recovered or refunded at a rate of 25 per cent. Additionally, a fuel rider is calculated based on the forecast fuel price and is added to, or subtracted from, the electrical rates that would otherwise be in effect.

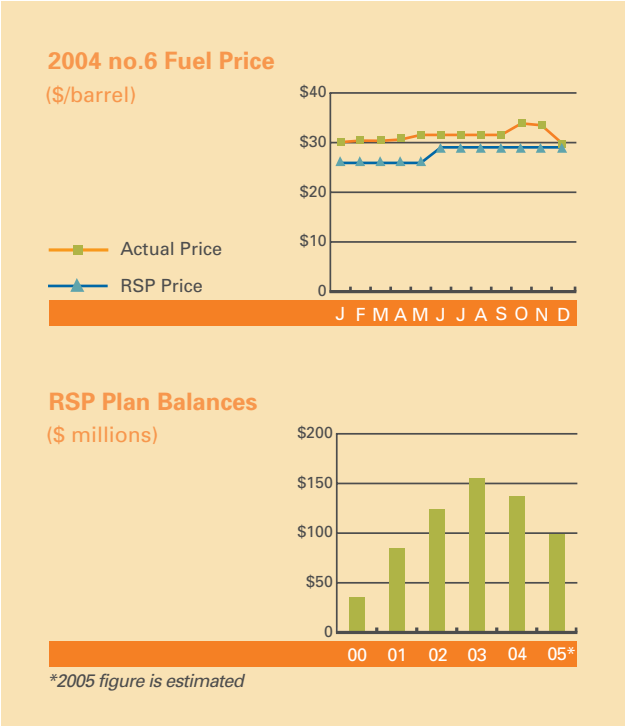
During 2004, the activity in the RSP resulted in a long-term hydraulic balance owing to customers of $5.5 million and an outstanding balance owing from customers, for the other components of the plan, of $8.6 million which is to be recovered during 2005.

Based on a forecast No. 6 fuel price of $33.19 per barrel, Hydro is projecting a new RSP balance of $2.7 payable to accumulate by year-end 2005.

HUMAN RESOURCES

Human resource management including recruitment and retention of a qualified workforce, compensation, training and development and succession planning will continue to be key to Hydro's continued success as 25 per cent of its workforce are eligible for retirement over the next five years. Implementing strategies and practices to manage succession is a critical challenge for human resource practitioners and line managers to ensure Hydro's long-term success.

From a strategic perspective, the Hydro Group is facing many of the same challenges with respect to recruitment and retention of journeyperson trades staff as the other Atlantic utilities. However, recent contract settlements at other Atlantic utilities, and the introduction of a two-year wage freeze for the Hydro Group, has brought additional complexity to the succession planning efforts of management.



INFRASTRUCTURE AND TECHNOLOGY

Hydro's generation and transmission facilities were constructed primarily from the 1960s to the 1970s. Many facilities are now approaching 40 years of age and require increasing amounts of maintenance to maintain acceptable levels of reliability. Significant capital investment is also required each year to ensure that facilities and equipment are upgraded, replaced or installed to meet the increasing demand for electrical energy from our customers. As well, increased environmental expectations and regulations have spurred increased capital investment as well as operational costs. In 2004, Hydro implemented a new Wood Pole Management Program. This program includes the inspection, testing and treatment of Hydro's 26,000 wood transmission poles which will extend the life of these assets for at least ten years.

New technologies and processes in many areas of our business may affect the way the Corporation operates in the future and Hydro will integrate these as equipment is changed and processes developed. Renewable energy sources such as wind may also offer potential for cost-effective generation of power as the technology becomes mature and the unit cost decreases.

ENVIRONMENT

Environmental issues are a significant consideration for electric utilities. In an effort to continue to provide reliable service while realizing its responsibility to the environment, Hydro adopted the ISO 14001 Environmental Management System (EMS) standard in 1997 and as of early 2004, all environmental aspects associated with the Hydro Group of Companies are managed through an EMS consistent with the ISO 14001:1996 standard. Hydro's EMS has been certified and registered by an external auditor. The EMS has entered into its maintenance phase and is providing continual improvements in environmental management and performance. ISO 14001 is the foundation of the Canadian Electrical Association's Environmental Commitment and Responsibility Program. This international standard of environmental management requires organizations to make a commitment to comply with legal and other requirements, prevent pollution and work to continually improve their environmental performance.

Hydro has developed an Environmental Site Assessment Program that is designed to assess our land holdings for contamination and to systematically quantify and reduce the Hydro Group's environmental liability over time.

The Kyoto Accord will become binding in 2005. Part of the Federal Government's plan for compliance is to reduce emission from Large Final Emitters (LFE) by approximately 15 per cent. The Holyrood Thermal Generating Station (HTGS) is considered an LFE, and while the details of how Kyoto compliance will be achieved are unknown at this time, it will significantly affect the way Hydro operates and its costs.

Emissions from HTGS are reported to the National Pollution Release Inventory and the provincial Department of Environment and Conservation. New air emissions regulations beginning in 2005 will mean a reduction in the sulfur content of fuel from 2.2 per cent to 2.0 per cent and there is increasing pressure for emissions reduction. In 2004, Hydro began updating the 1999 Cantox Air Emissions Human Health Risk Assessment. The results are expected in 2005.

RISK MANAGEMENT

Hydro operates in an environment that entails various forms of business and financial risk. Some of these risks afford Hydro added opportunities, but others expose the company to risk and uncertainty that may lead to adverse impacts on our financial position and corporate objectives.

The Corporation is subject to business risks associated with damage of its assets, interruption of service and liability claims. The Hydro Group recognizes these exposures and employs a variety of risk control and financing techniques. Regular maintenance and inspection of assets, redundancy of critical facilities and other loss prevention solutions are utilized to eliminate and/or reduce these exposures. The Corporation's Insurance Program, covering all assets and specified liabilities, is reviewed and negotiated with insurers annually. The review focuses on exposures to loss, adequacy of coverage limits deductible levels, self-insured exposures and loss history. On completion of the annual review, strategies will be developed to ensure renewal negotiations result in provision of optimal coverage terms for the Corporation at a competitive cost. A further risk management initiative currently being developed is the formulation and implementation of a Business Continuity Plan. This plan will be utilized by the Corporation to identify and rank potential catastrophic events and to document procedures to mitigate damages and maintain and/or restart operations following such events.

As an electrical utility, the working environment for the majority of Hydro's employees is hazardous and unforgiving. To ensure that its employees are protected from accidents and industrial illness, Hydro has established a comprehensive Safety and Health Program. The program draws on industry best practices, state of the art personal protective equipment, task analysis and standardized work methods, and engineered solutions to provide employees with a safe environment in which to work. The safety and well being of its workforce is a priority for Hydro.

Financial risks include changes in interest rates and fluctuation in foreign currency exchange rates. The Corporation manages its exposure to interest rates through ongoing benchmarking against key indices, having due consideration for the company's relative risk profile. The company mitigates its foreign exchange exposure through a diversified approach that includes the periodic use of forward currency contracts.

BUSINESS PROCESS IMPROVEMENT

In 2002, Hydro developed a structured program to review core business processes, as part of an overall continuous improvement program. Hydro's objective, as part of its strategic plan, is to eliminate non-value added work in its business processes and leverage the functionality of its integrated software suite to support process improvement and deliver better business information, effective budgeting and work management tools.

Each process review has resulted in an extensive and detailed analysis of the work, how it is performed and the opportunities for improvement. To date, Hydro has reviewed 11 business processes, seven of which have been redesigned and are in various stages of implementation.

The Holyrood Thermal Generating Station produces 30 to 40 per cent of the island's annual energy requirements.

Terry LeDrew heads the team of dedicated employees who keep this integral supply running efficiently.

Management Report

The accompanying consolidated financial statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 15, 2005. Financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis, and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditor, Deloitte & Touche LLP, is to express an independent, professional opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfils its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with Management, the internal auditors and the external auditors to satisfy itself that each group has properly discharged its respective responsibility and to review the financial statements before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.

John C. Roberts
Vice-President, Finance and Chief Financial Officer

William E. Wells
President and Chief Executive Officer

Auditors' Report

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2004, and the consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2004, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Chartered Accountants
St. John's, Newfoundland and Labrador
Canada
February 15, 2005

Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2004**	2003
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,653.5**	2,632.5
Less contributions in aid of construction	**106.9**	106.5
	2,546.6	2,526.0
Less accumulated depreciation	**816.3**	780.5
	1,730.3	1,745.5
Construction in progress	**54.2**	47.5
	1,784.5	1,793.0
Current assets		
Cash and cash equivalents	**4.0**	0.1
Accounts receivable	**67.2**	56.5
Current portion of long-term receivables (Note 3)	**41.5**	35.5
Current portion of rate stabilization plan	**8.6**	-
Fuel and supplies at average cost	**48.3**	48.5
Prepaid expenses	**2.0**	2.5
	171.6	143.1
Long-term receivables (Note 3)	**97.7**	130.7
Sinking funds (Note 10)	**87.1**	70.1
Investments (Note 4)	**5.2**	5.2
Deferred charges (Note 6)	**85.0**	89.2
	2,231.1	2,231.3

See accompanying notes

Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2004**	2003
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,422.1**	1,447.8
Current liabilities		
Bank indebtedness	**8.0**	6.7
Short-term borrowing	**-**	1.8
Accounts payable and accrued liabilities	**49.1**	51.6
Accrued interest	**30.3**	30.5
Long-term debt due within one year (Note 7)	**28.4**	30.7
Promissory notes (Note 7)	**157.8**	149.8
	273.6	271.1
Rate stabilization plan	**5.5**	-
Long-term payable (Note 8)	**1.1**	-
Employee future benefits (Note 9)	**35.4**	32.0
Non-controlling interest in LCDC (Note 2)	**2.5**	2.5
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Notes 2 and 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	100.0
Retained earnings	**354.4**	337.8
	490.9	477.9
Commitments and contingencies (Note 12)	-	-
	2,231.1	2,231.3

See accompanying notes

On behalf of the Board:

Dean MacDonald
Director

Ken Marshall
Director

Consolidated Statement of Income and Retained Earnings

Year ended December 31 (millions of dollars)	**2004**	2003
Revenue		
Energy sales	**439.8**	407.8
Recovery of costs in rate stabilization plan	**34.2**	16.7
Guaranteed winter availability	**14.6**	11.9
Rentals and royalties	**0.3**	0.3
Other	**4.6**	4.8
	493.5	441.5
Expenses		
Operations and administration	**123.4**	125.8
Fuels	**83.1**	84.6
Amortization of costs in rate stabilization plan	**34.2**	16.7
Power purchased	**36.1**	26.1
Depreciation	**45.8**	45.0
Interest (Note 11)	**103.7**	99.3
	426.3	397.5
Net income before unusual items	**67.2**	44.0
Unusual items (Note 2)		
Write-down of capital assets	**-**	(130.9)
Less non-controlling interest	**-**	12.3
	-	(118.6)
Net income (loss)	**67.2**	(74.6)
Retained earnings, beginning of year	**337.8**	453.5
	405.0	378.9
Dividends	**50.6**	41.1
Retained earnings, end of year	**354.4**	337.8

See accompanying notes

Consolidated Statement of Cash Flows

Year ended December 31 (millions of dollars)	**2004**	2003
Cash provided by (used in)		
Operating activities		
Net income (loss)	**67.2**	(74.6)
Adjusted for items not involving a cash flow		
Depreciation	**45.8**	45.0
Amortization of deferred charges	**3.7**	4.1
Rate stabilization plan	**(3.1)**	20.5
Loss on disposal of capital assets	**1.7**	3.2
Other	**-**	(0.6)
Foreign exchange gain	**(0.1)**	(1.0)
Write-down of capital assets (net of non-controlling interest)	**-**	118.6
	115.2	115.2
Change in non-cash balances related to operations		
Accounts receivable	**(10.7)**	5.5
Fuel and supplies	**0.2**	(0.5)
Prepaid expenses	**0.5**	-
Accounts payable and accrued liabilities	**(0.2)**	(8.2)
Accrued interest	**(0.2)**	2.8
Employee future benefits	**3.4**	2.4
Long-term receivable	**21.8**	(49.6)
Long-term payable	**1.1**	-
	131.1	67.6
Financing activities		
Long-term debt issued	**-**	125.0
Long-term debt retired	**(20.8)**	(36.8)
Foreign exchange loss recovered	**2.7**	5.2
Decrease in short-term borrowing	**(1.8)**	(1.5)
Increase (decrease) in promissory notes	**8.0**	(31.7)
Decrease in contributed capital	**(3.6)**	-
Dividends	**(50.6)**	(41.1)
	(66.1)	19.1
Investing activities		
Net additions to capital assets	**(40.1)**	(67.3)
Proceeds from the disposal of capital assets	**1.1**	0.8
Increase in sinking funds	**(21.6)**	(19.2)
Reductions (additions) to deferred charges	**0.5**	(3.9)
Change in accounts payable related to investing activities	**(2.3)**	0.5
	(62.4)	(89.1)
Net increase (decrease) in cash	**2.6**	(2.4)
Cash position, beginning of year	**(6.6)**	(4.2)
Cash position, end of year	**(4.0)**	(6.6)
Cash position is represented by		
Cash and cash equivalents	**4.0**	0.1
Bank indebtedness	**(8.0)**	(6.7)
	(4.0)	(6.6)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.2**	0.6
Interest paid	**112.0**	109.6

See accompanying notes

Notes to Consolidated Financial Statements

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown Corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited (Twin Falls), are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations

(Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are regulated on the basis of return on rate base. As well, Hydro's borrowing and capital expenditure programs are subject to review and approval by the Public Utilities Board of Commissioners (PUB).

Rates charged rural customers do not recover the full costs of providing the service but Hydro recovers the resulting deficit from other customers.

Hydro has adopted selected accounting treatments that differ from that for enterprises not subject to rate regulation. The more significant of these include the following:

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year. RSP balances which accumulated prior to December 31, 2003 (Note 3), have been converted to a long-term receivable. Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25 per cent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added or subtracted from the rates that would otherwise be in effect.

Foreign Exchange Losses

Foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. This amortization is included in interest expense. Commencing in 2002, the PUB ordered Hydro's deferred foreign exchange losses, net of the $10.0 million provision previously accumulated, be amortized over a forty-year period (Note 6).

Capital Assets and Depreciation

Hydro follows the capitalization and depreciation policies as described in Note 1, which have been approved by the PUB.

Deferred Regulatory Costs

In 2004, the PUB approved the deferral of external costs associated with the general rate application and hearing, in the amount of $1,800,000, which is to be amortized over a 3-year period.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited (GIPCo), (100% owned) and Lower Churchill Development Corporation Limited (LCDC), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co) and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co subsequent to the effective date of the shareholders' agreement.

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,000 kilowatts (CF(L)Co Project). A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from the CF(L)Co Project until 2041. CF(L)Co receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

CF(L)Co holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives CF(L)Co joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

The cost of Hydro's investment in CF(L)Co exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2004, $34.7 million (2003 - $33.6 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project), (Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development), (Note 4).

Twin Falls is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. Both are stated at cost, which approximates market value. As at December 31, 2004, and 2003, there were no cash equivalents or short-term investments outstanding.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

During 2004, Hydro adopted the recommendations of the Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3110, *Asset Retirement Obligations*. This new accounting standard requires that the company recognize the fair value of the future expenditures required to settle legal obligations associated with the retirement of capital assets, to the extent that it is reasonably estimable. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Hydro, GIPCo and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co

CF(L)Co uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Promissory Notes

Promissory Notes bear interest from 2.10% to 2.86% per annum (2003 - 2.66% to 2.93%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2003 - 7%).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd.)

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date.

(i) Under the provisions of the Power Contract CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 3).

Financial Instruments

From time to time, Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

2. CAPITAL ASSETS

millions of dollars	Capital Assets in Service	Contributions in Aid of Construction	Accumulated Depreciation	Construction in Progress
		2004		
Generation Plant				
Hydroelectric	**1,350.4**	**20.5**	**278.2**	**0.2**
Thermal	**228.1**	**-**	**177.4**	**-**
Diesel	**56.8**	**6.5**	**24.1**	**0.4**
Transmission and Distribution	**730.9**	**55.1**	**183.2**	**0.2**
Service facilities	**22.0**	**-**	**10.1**	**-**
Project costs (Note 4)	**-**	**-**	**-**	**-**
Capital studies (Note 4)	**-**	**-**	**-**	**-**
Other	**265.3**	**24.8**	**143.3**	**53.4**
	2,653.5	**106.9**	**816.3**	**54.2**

millions of dollars		2003		
Generation Plant				
Hydroelectric	1,347.3	20.5	267.0	0.2
Thermal	227.0	-	175.7	-
Diesel	59.5	6.7	23.4	-
Transmission and Distribution	718.2	54.9	168.5	0.6
Service facilities	22.0	-	9.8	-
Project costs (Note 4)	-	-	-	-
Capital studies (Note 4)	-	-	-	-
Other	258.5	24.4	136.1	46.7
	2,632.5	106.5	780.5	47.5

Included in the above amounts are CF(L)Co assets in service amounting to $639.3 million (2003 - $636.1 million) which are pledged as collateral for long-term debt.

As at December 31, 2003, Management reviewed the carrying balance of its Capital Assets in Service and Construction in Progress for hydro-electric developments in Labrador. As Hydro had been unable to successfully conclude development plans at that time, it decided to write-down project costs related to GIPCo by $96.3 million, capital studies related to LCDC by $25.0 million, and construction in progress by $9.6 million, to its best estimate of the net recoverable amount. The write-down of capital studies also resulted in a reduction of $12.3 million in the non-controlling interest in LCDC. The project costs in GIPCo and capital studies in LCDC were funded by the shareholder in prior years through the provision of contributed capital.

3. LONG-TERM RECEIVABLES

millions of dollars	**2004**	2003
Rate Stabilization Plan		
Retail	**101.7**	114.8
Industrial	**32.3**	40.9
	134.0	155.7
Hydro-Québec		
Unrealized foreign exchange	**4.3**	9.5
Other	**0.9**	1.0
	5.2	10.5
Less current portion of long-term receivables	**41.5**	35.5
	97.7	130.7

The receivable arising from the RSP bears interest at the weighted average cost of capital which is approximately 7.2% and is to be recovered over a five-year period, which commenced in 2003.

4. INVESTMENTS

millions of dollars	**2004**	2003
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (Option Agreement). The purchase price in respect of GIPCo's assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2005.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

5. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2004, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2004.

millions of dollars	**2004**	2003
Current assets	**25.1**	24.0
Long-term assets	**338.6**	347.9
Current liabilities	**23.8**	29.4
Long-term liabilities	**66.6**	84.0
Revenues	**63.9**	61.7
Expenses	**47.3**	48.5
Net income	**16.6**	13.2
Cash provided by (used in)		
Operating activities	**33.2**	34.1
Financing activities	**(21.0)**	(30.4)
Investing activities	**(5.3)**	(2.6)

6. DEFERRED CHARGES

millions of dollars	**2004**	2003
Debt discount, financing expenses and other	**16.9**	20.1
Accumulated amortization	**11.7**	12.9
	5.2	7.2
Foreign exchange losses realized	**96.3**	96.3
Accumulated provision	**10.0**	10.0
	86.3	86.3
Accumulated amortization	**6.5**	4.3
	79.8	82.0
Net deferred charges	**85.0**	89.2

7. LONG-TERM DEBT

	Hydro	CF(L)Co	Total	Hydro	CF(L)Co	Total
millions of dollars		**2004**			2003	
Summary of long-term debt						
Long-term debt	**1,369.3**	**81.2**	**1,450.5**	1,377.2	101.3	1,478.5
Less payments due within one year	**13.8**	**14.6**	**28.4**	13.4	17.3	30.7
	1,355.5	**66.6**	**1,422.1**	1,363.8	84.0	1,447.8

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2005	2006	2007	2008	2009
	28.4	227.3	27.4	213.7	13.8

The payments due within one year include sinking fund requirements of $10.0 million (2003 - $10.0 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2004**	2003	
AC	5.05	2001	2006	**200.0**	200.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	300.0	(a)
AD	5.70	2003	2033	**125.0**	125.0	(a)
Total debentures				**1,400.0**	1,400.0	
Less sinking fund investments in own debentures				**48.3**	43.8	
				1,351.7	1,356.2	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**16.4**	18.8	
Other				**1.2**	2.2	
				1,369.3	1,377.2	
Less payments due within one year				**13.8**	13.4	
				1,355.5	1,363.8	

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co

millions of dollars	**2004**	2003
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $32.0; 2003 - U.S. $43.6)	**38.3**	56.4
7.875% Series B due December 15, 2007	**3.2**	4.4
General Mortgage Bonds		
7.500% due December 15, 2010	**39.7**	40.5
	81.2	101.3
Less payments due within one year	**14.6**	17.3
	66.6	84.0

7. LONG-TERM DEBT (Cont'd.)

CF(L)Co (Cont'd.)

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however fixed sinking fund payments are estimated to average $9.2 million in each of the years 2005 to 2009 inclusive.

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends, based on cash flow.

8. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, bears interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2003 - nil) is included in accounts payable and accrued liabilities.

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of $4.1 million (2003 - $4.1 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. The most recent actuarial valuation was performed as at December 31, 2004.

millions of dollars	**2004**	2003
Accrued benefit obligation		
Balance at beginning of year	**39.5**	37.5
Current service cost	**1.6**	1.3
Interest cost	**2.8**	2.6
Actuarial loss	**4.2**	-
Benefits paid	**(1.7)**	(1.9)
Balance at end of year	**46.4**	39.5
Plan deficit	**46.4**	39.5
Unamortized actuarial loss	**(10.7)**	(7.1)
Unamortized past service cost	**(0.3)**	(0.4)
Accrued benefit liability at end of year	**35.4**	32.0

millions of dollars	**2004**	2003
Current service cost	**1.6**	1.3
Interest cost	**2.8**	2.6
Actuarial losses	**4.2**	-
	8.6	3.9
Adjustments		
Difference between actual actuarial loss and amount recognized	**(3.4)**	0.4
Benefit expense	**5.2**	4.3

9. EMPLOYEE FUTURE BENEFITS (Cont'd.)

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2004	2003
Discount rate	**6.3%**	7.0%
Rate of compensation increase	**3.5%**	3.5%
Assumed healthcare trend rates:		
	2004	2003
Initial healthcare expense trend rate	**12.0%**	12.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2010**	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2004:

	Increase	Decrease
Current service cost	**0.2**	(0.2)
Interest cost	**0.5**	(0.3)
Accrued benefits obligation	**6.7**	(2.1)

10. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2004 and 2003 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2004 of the total accounts receivable balance outstanding approximately 51.8% (2003 - 50.0%) is due from a regulated utility, and 19.8% (2003 - 24.0%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.77% to 9.86% (2003 - 5.33% to 9.86%).

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
millions of dollars	**2004**		2003	
Financial Assets				
Sinking funds	**87.1**	**96.9**	70.1	76.3
Long-term receivable including amount due in one year	**139.1**	**139.0**	166.2	166.2
Financial Liabilities				
Long-term debt including amount due in one year	**1,450.5**	**1,766.9**	1,478.5	1,769.6
Long-term payable including amount due in one year	**1.5**	**1.6**	-	-

11. INTEREST EXPENSE

millions of dollars	**2004**	2003	
Gross interest			
Long-term debt	**110.4**	109.9	
Promissory notes	**4.1**	5.7	
	114.5	115.6	
Amortization of debt discount and financing expenses	**1.1**	1.0	
Provision for foreign exchange losses	**2.2**	2.2	
Foreign exchange gain	**(0.2)**	(1.0)	
	117.6	117.8	
Less			
Recovered from Hydro-Québec	**2.2**	3.2	(a)
Interest capitalized during construction	**3.6**	7.3	
Interest earned	**22.7**	21.9	
Net interest expense	**89.1**	85.4	
Debt guarantee fee	**14.6**	13.9	
Net interest and guarantee fee	**103.7**	99.3	

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

12. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

The results of a recent Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicate higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing is to be conducted to determine the extent of contamination, and a remediation plan will be developed in consultation with regulatory agencies. At this time potential liability cannot be estimated due to insufficient knowledge of the extent of contamination. Further, there is uncertainty with respect to whether Twin Falls or CF(L)Co is responsible for any environmental liabilities that are determined to exist.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately $8.5 million (2003 - $16.2 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $22.2 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $7.4 million at December 31, 2004 (2003 - $14.1 million).

13. COMPARATIVE FIGURES

Certain of the 2003 comparative figures have been reclassified to conform with the 2004 financial statement presentation.

Our team of friendly and knowledgeable customer service representatives are here to meet your needs.

Collette Barnes and Michelle Kirby bring experience, knowledge and professionalism to our customers every day.

Financial Statistics

Years ended December 31 (millions of dollars)	**2004**	2003	2002	2001 [1]	2000
OPERATING RESULTS					
Revenue					
Energy sales	**439.8**	407.8	399.6	374.8	357.0
Rentals and royalties	**0.3**	0.3	0.3	0.3	0.3
Recovery of costs in RSP	**34.2**	16.7	14.0	11.2	13.9
Guaranteed winter availability	**14.6**	11.9	9.5	7.5	4.6
Other	**4.6**	4.8	4.2	3.3	3.9
	493.5	441.5	427.6	397.1	379.7
Expenses					
Operations and administration	**123.4**	125.8	125.8	119.1	119.4
Amortization of RSP costs	**34.2**	16.7	14.0	11.2	13.9
Fuels and power purchased	**119.2**	110.7	89.0	65.8	58.3
Depreciation	**45.8**	45.0	43.0	44.5	47.7
Interest	**103.7**	99.3	97.8	102.5	105.5
	426.3	397.5	369.6	343.1	344.8
Income before unusual items	**67.2**	44.0	58.0	54.0	34.9
Write down of capital assets	**-**	130.9	-	-	-
Net income (loss) before non-controlling interest	**67.2**	(86.9)	58.0	54.0	34.9
Non-controlling interest	**-**	(12.3)	-	-	-
Net income (loss)	**67.2**	(74.6)	58.0	54.0	34.9
Contributions to net income (loss)					
Hydro Corporate	**47.6**	18.1	40.9	40.4	17.4
CF(L)Co	**19.6**	16.3	17.1	13.6	17.5
GIPCo	**-**	(96.3)	-	-	-
LCDC	**-**	(12.7)	-	-	-
FINANCIAL POSITION					
Total current assets	**171.6**	143.1	140.2	141.2	129.7
Total current liabilities	**273.6**	271.1	326.4	360.6	378.8
Net working capital	**(102.0)**	(128.0)	(186.2)	(219.4)	(249.1)
Capital assets	**2,600.8**	2,573.5	2,650.4	2,545.6	2,459.5
Accumulated depreciation	**816.3**	780.5	745.7	707.6	669.6
Capital assets, net	**1,784.5**	1,793.0	1,904.7	1,838.0	1,789.9
Sinking funds	**87.1**	70.1	48.7	42.7	35.4
Other assets	**187.9**	225.1	225.7	202.3	186.6
Long-term debt	**1,422.1**	1,447.8	1,354.9	1,156.7	1,043.3
Other liabilities	**44.5**	34.5	44.4	43.3	50.9
Shareholder's equity	**490.9**	477.9	593.6	663.6	668.6
STAFFING LEVELS AT YEAR END					
Full Time Equivalents (FTE)[2]	**1,149**	1,190	1,220	1,246	-

(1) Restated to reflect Churchill Falls' adoption of new recommendations of the Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses.

(2) Hydro has adopted the full time equivalent (FTE) method of reporting its staffing levels. Data on an FTE basis is not available prior to 2001.

Operating Statistics

Years ended December 31	**2004**	2003	2002	2001	2000
INSTALLED GENERATING CAPACITY (rated MW)					
CF(L)Co	**5,428**	5,428	5,428	5,428	5,428
Twin Falls	**225**	225	225	225	225
Hydro					
Hydraulic	**939**	939	899	899	899
Thermal	**640**	640	640	640	640
Diesel	**55**	57	57	58	58
Total	**7,287**	7,289	7,249	7,250	7,250
ELECTRIC ENERGY GENERATED, NET (GWh)					
CF(L)Co	**32,395**	33,457	35,516	32,910	35,143
Hydro					
Hydraulic	**4,726**	4,321	3,986	3,959	5,016
Thermal	**1,641**	1,950	2,380	2,095	966
Diesel	**46**	45	48	46	43
Total	**38,808**	39,773	41,930	39,010	41,168
ELECTRIC ENERGY SALES (GWh)					
CF(L)Co					
Export	**27,929**	28,647	30,782	28,159	30,268
Hydro					
Utility	**4,709**	4,642	4,589	4,423	4,263
Rural	**886**	878	894	832	842
Industrial	**1,842**	1,711	1,675	1,528	1,607
Export	**1,456**	1,439	1,481	1,558	1,494
Total	**36,822**	37,317	39,421	36,500	38,474
AVERAGE RATE (cents per kWh)					
CF(L)Co					
Export	**0.26**	0.25	0.25	0.27	0.27
Hydro					
Utility	**4.99**	4.79	4.60	4.50	4.49
Rural	**5.87**	5.68	5.59	5.60	5.53
Industrial	**3.24**	3.14	3.08	3.14	2.85
Export	**3.41**	2.27	2.27	2.22	2.22
TRANSMISSION LINES (km)					
CF(L)Co					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,608**	1,608	1,533	1,534	1,536
138 kV	**1,500**	1,500	1,533	1,533	1,533
69 kV	**589**	589	586	587	586
Total	**4,736**	4,736	4,691	4,693	4,694
PEAK DEMAND (MW)					
CF(L)Co System	**5,645**	5,615	5,587	5,637	5,606
Hydro System	**1,405**	1,402	1,403	1,262	1,240

Glossary of Terms

Cogeneration
The simultaneous generation of electricity and useful heat or steam. The heat could be put to use in an industrial process or to heat a facility or community. The electricity could be used by the owner or sold.

Demand
The rate at which electric energy is delivered at a given instant or averaged over a period of time. It is measured in kilowatts, megawatts, etc.

Distribution
Process of moving electric energy at lower voltages from major substations to customers.

Electrical Energy
The quantity of electricity delivered over a period of time. The commonly used unit of electrical energy is the kilowatt hour (KWh).

Electrical Power
The rate of delivery of electrical energy and the most frequently used measure of capacity. The basic unit is the kilowatt (KW).

Frequency
The number of cycles through which an alternating current passes in a second. The North American standard is 60 cycles per second, known as 60 hertz.

Gigawatt Hour (GWh)
A unit of bulk energy; 1,000,000 kilowatt hours.

Installed Generating Capacity
The rated load that can be supplied by a generating unit, power station or an entire provincial grid system.

ISO14001
A family of environmental management standards developed by the International Organization for Standardization.

Kilowatt Hour (kWh)
A unit of bulk energy; 1,000 watt hours. The measurement is generally used for billing residential customers.

Load
The amount of electric power or energy consumed by a particular customer or group of customers.

Megawatt (MW)
A unit of bulk power; 1,000 kilowatts. The unit generally used to describe the output of a commercial generator.

Megawatt Hour (MWh)
A unit of bulk energy; 1,000 kilowatt hours.

Mills
1/10 of one cent or 1/1000 of one dollar.

Peak Demand
The maximum amount of electric power consumed by a particular customer or group of customers at a precise time.

Power System
All the interconnected facilities of an electrical utility. A power system includes all the generation, transmission, distribution, transformation, and protective components necessary to provide service to the customers.

Safety Frequency Rate
The number of work-related injuries or illnesses that result in lost work time during the year.

System Average Interruption Duration Index (SAIDI)
The average service interruption length in hours from a customer's point of view. This is used to track the performance in responding to outages. The target is based on historical performance.

System Average Interruption Frequency Index (SAIFI)
The average service interruption frequency from a customer's point of view. This is used to track the overall performance of Hydro's distribution system. The target is based on historical performance.

Substation/Terminal Station
A distribution centre principally used for stepping up or stepping down the voltage through transformers or switching on and off transmission lines.

Terawatt Hours (TWh)
A unit of bulk energy; 1,000,000,000 kilowatt hours.

Transformer
A device that raises or lowers voltages.

Transmission
Process of moving electric power in bulk at higher voltages through the system.

Voltage
The electrical force or potential that causes a current to flow in a circuit (just as pressure causes water to flow in a pipe). Voltage is measured in volts (V) or kilovolts (kV). 1 kV = 1000 V

Watt
The scientific unit of electric power. A typical light bulb is rated 25, 40, 60 or 100 watts, meaning that it consumes that amount of power when illuminated.

Hydro's commitment to reliable service is fulfilled by employees all across Newfoundland and Labrador.

Our Transmission Line Crews like Todd Jones, Jim Hoskins and Cecil Dyke brave all winds and weather to make sure you don't have to worry that your lights stay on.

Executive Management

Left to right: Fred Martin, John Roberts, Bill Wells, Jim Haynes, Maureen Greene

Board of Directors

NEWFOUNDLAND AND LABRADOR HYDRO

Dean MacDonald
Chief Executive Officer
Persona Inc.

Bruce Saunders
Deputy Minister
Department of Natural Resources

Elmer Harris
Retired

Barbara Fong
Executive Vice-President
Instrumar Ltd.

William Kelly
Electrician
Wabush Mines

Craig Tucker
Vice-President
M5 Marketing Communications Inc.

Ken Marshall
Vice-President and General Manager
Rogers Cable – Atlantic Region

Dr. David Smallwood
Educational Consultant

William E. Wells
President and Chief Executive Officer
Newfoundland and Labrador Hydro

CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED

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Chief Executive Officer
Persona Inc.

William E. Wells
President and Chief Executive Officer
Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited

Albert Hickman
President
Hickman Motors Limited

Marie-José Nadeau
Executive Vice-President Corporate Affairs and Secretary General
Hydro-Québec

Leonard Stirling
Retired Insurance Broker

Thierry Vandal
President
Hydro-Quebéc Production

Robert Warr
Managing Director
Nor-Lab Limited

LOWER CHURCHILL DEVELOPMENT CORPORATION LIMITED

Dean MacDonald
William E. Wells
John C. Roberts
James R. Haynes

GULL ISLAND POWER COMPANY LIMITED

Dean MacDonald
William E. Wells
James R. Haynes
John C. Roberts

TWIN FALLS POWER CORPORATION LIMITED

Maureen P. Greene
President Twin Falls Power Corporation Limited

Fred H. Martin
Vice-President, Transmission and Rural Operations
Newfoundland and Labrador Hydro

John C. Roberts
Vice-President, Finance and Chief Financial Officer
Newfoundland and Labrador Hydro

James R. Haynes
Vice-President, Production
Newfoundland and Labrador Hydro

Andrew E. MacNeill
General Manager
Churchill Falls (Labrador) Corporation Limited

Maurice McClure
General Manager Financial Planning and Cost Management
Iron Ore Company of Canada

Stephen Fontanals
Controller
Wabush Mines

Gerald P. Kohanski
General Manager Materials and Energy
Cleveland-Cliffs Inc.

Matthew Simpson
Manager, Energy
Iron Ore Company of Canada

Officers

NEWFOUNDLAND AND LABRADOR HYDRO

Dean MacDonald
Chair

William E. Wells
President and Chief Executive Officer

James R. Haynes
Vice-President, Production

Maureen P. Greene
Vice-President, Human Resources, General Counsel and Corporate Secretary

John C. Roberts
Vice-President, Finance and Chief Financial Officer

Fred H. Martin
Vice-President, Transmission and Rural Operations

Peter A. Hickman
Assistant Corporate Secretary

Mark G.S. Bradbury
Director, Finance

TWIN FALLS POWER CORPORATION LIMITED

Maureen P. Greene
President

John C. Roberts
Vice-President, Finance and Chief Financial Officer

Andrew E. MacNeill
General Manager

Mark G.S. Bradbury
Director, Finance

Peter A. Hickman
Corporate Secretary

LOWER CHURCHILL DEVELOPMENT CORPORATION LIMITED

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Chair

William E. Wells
President and Chief Executive Officer

David Burpee
Vice-Chair

Maureen P. Greene
Corporate Secretary

Mark G.S. Bradbury
Treasurer

Peter A. Hickman
Assistant Corporate Secretary

CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED

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Chair

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President and Chief Executive Officer

Maureen P. Greene
Vice-President, Human Resources, General Counsel and Corporate Secretary

John C. Roberts
Vice-President, Finance and Chief Financial Officer

Andrew E. MacNeill
General Manager

Mark G.S. Bradbury
Director, Finance

Peter A.Hickman
Assistant Corporate Secretary

GULL ISLAND POWER COMPANY LIMITED

Dean MacDonald
Chair

William E. Wells
President and Chief Executive Officer

James R. Haynes
Vice-President, Production

Maureen P. Greene
Vice-President, Human Resources, General Counsel and Corporate Secretary

John C. Roberts
Vice-President, Finance and Chief Financial Officer

Mark G.S. Bradbury
Treasurer

Peter A. Hickman
Assistant Corporate Secretary

CORPORATE CITIZENSHIP – COMMITTED TO THE COMMUNITY

In 2004, Hydro supported many organizations in their efforts to improve the quality of life for Newfoundlanders and Labradorians including:

Arthritis Society – Newfoundland and Labrador Division Canadian Cancer Society – Relay for Life, Captain William Jackman Memorial Hospital, Central Newfoundland Regional Heath Centre, Cerebral Palsy Association of Newfoundland, Dr. H. Bliss Murphy Cancer Centre, Easter Seals of Newfoundland and Labrador, General Hospital Health Foundation, Grenfell Regional Health Services, Healing Hands Campaign (South and Central Health Foundation), Health Labrador Corporation, Heart & Stroke Foundation, James Paton Memorial Hospital, Janeway Children's Hospital Foundation, Western Memorial Regional Hospital Foundation, Learning Disabilities Association of Newfoundland & Labrador, Big Brothers/Big Sisters, East Coast Trail Association, IEEE Annual Provincial Conference, Institute of Power Engineers, Nature Conservancy of Canada, Professional Engineers & Geoscientists of Newfoundland and Labrador, Public Legal Information Association of Newfoundland and Labrador, Straits/St. Barbe Chamber of Commerce, YM-YWCA and Festival 500.

2004 Installed Generating Capacity

Megawatts (MW)

THE HYDRO GROUP

CF(L)Co

LABRADOR

Interconnected

Hydraulic

Churchill Falls	5,428

HYDRO

LABRADOR

Interconnected

Thermal (Diesel)

Happy Valley-Goose Bay	11.7
Mud Lake	0.2

Thermal (Gas Turbine)

Happy Valley-Goose Bay	27.0

Rural Isolated

Thermal (Diesel)

16 Sites	20.9
Black Tickle	
Cartwright	
Charlottetown	
Davis Inlet	
Hopedale	
L'Anse-au-Loup	
Makkovik	
Mary's Harbour	
Nain	
Norman Bay	
Paradise River	
Port Hope Simpson	
Postville	
Rigolet	
St. Lewis	
Williams Harbour	

ISLAND

Interconnected

Hydraulic

Bay D' Espoir	604
Cat Arm	127
Upper Salmon	84
Granite Canal	40
Hinds Lake	75
Paradise River	8
Snooks Arm/ Venams Bight	1
Roddickton	0.4

Thermal (Oil)

Holyrood	490

Thermal (Gas Turbine)

Hardwoods	54
Stephenville	54
Holyrood	15

Thermal (Diesel)

Hawke's Bay	5
St. Anthony	9.7

Rural Isolated

Thermal (Diesel)

7 Sites	7.9
François	
Grey River	
Little Bay Islands	
McCallum	
Ramea	
Rencontre East	
St. Brendan's	

LEGEND

Generating Station | Terminal Station | Diesel Plant

Transmission Lines

735-kV | 138-kV | Low Voltage

230-kV | 69-kV | Customer-Owned

2004 GROSS ISLAND INTERCONNECTED ENERGY SUPPLY

Gigawatt hours (GWh)

Hydraulic Generation	
Bay D' Espoir	2,840
Cat Arm	702
Upper Salmon	593
Hinds Lake	322
Granite Canal	247
Paradise River	32
Mini Hydro	7
	4,743
Percentage of Total Energy Supply	69%

Power Purchases	413
Percentage of Total Energy Supply	6%
Thermal Generation	
Holyrood	1,744
Gas Turbine and Diesel	2
	1,746
Percentage of Total Energy Supply	25%

Newfoundland and Labrador Hydro
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Newfoundland and Labrador Hydro
2005 Annual Report

HYDRO
THE POWER OF COMMITMENT

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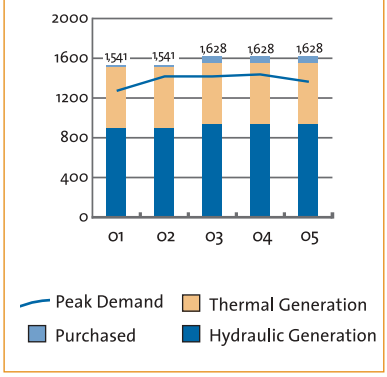
Fax: (709) 737-1231
Email: hydro@nlh.nl.ca
Website: www.nlh.nl.ca

Highlights

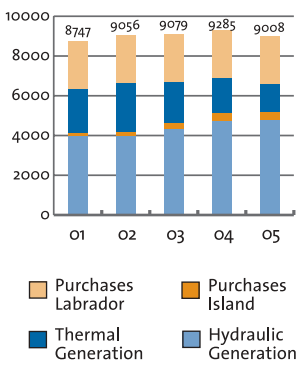
Island Interconnected System Gross Generating Capacity and Peak Demand

Megawatts (MW)



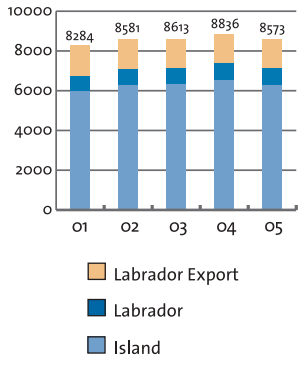
Interconnected Systems Gross Energy Generated and Purchased

Gigawatt Hours (GWh)



Interconnected Systems Energy Sales

Gigawatt Hours (GWh)



PASSIONATE. POTENTIAL.

WE ARE GROWING A DIVERSIFIED AND VIABLE ENERGY BUSINESS.

New Mandate, Renewed Focus

Newfoundland and Labrador Hydro (Hydro), is a Crown Corporation, owned by the Province of Newfoundland and Labrador. Hydro is the parent company of the Hydro Group of Companies (Hydro Group) comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation Limited (LCDC), Gull Island Power Company Limited (GIPCo) and Twin Falls Power Corporation Limited (TwinCo).

The Hydro Group's installed generating capacity of 7,288 megawatts (MW) makes it the fourth largest of all power utilities in Canada. Its power generating assets include the Churchill Falls Generating Station which is one of the largest underground powerhouses in the world with a rated capacity of 5,428 MW, one oil-fired plant, four gas turbines, 27 diesel plants and, including Churchill Falls, 10 operating hydroelectric plants.

With a dedicated workforce of 1,144 full-time equivalent employees, Hydro is the Province's main energy provider with electrical sales of 39,181 gigawatt hours (GWh) in 2005, 9,011 GWh for domestic use and 30,170 GWh for export. The company also maintains over 4,780 km of transmission lines.

Hydro continues to be focused on delivering safe, reliable, least-cost power to residents, businesses and industrial customers in Newfoundland and Labrador. In 2005, our shareholder, the Province of Newfoundland and Labrador, gave Hydro an expanded mandate to grow our business and to pursue new energy opportunities. With our shareholder and Board of Directors aligned on strategic goals, the company restructured to pursue opportunities in Labrador hydro developments, alternative energy, and oil and gas, while still maintaining a strong focus on its core business, providing least-cost power to Newfoundlanders and Labradorians.

There are presently four distinct business areas within Hydro: Regulated Operations; Churchill Falls Operations; Lower Churchill Development Project; and, Business Development. The potential of each is fueled by vision and energy.

FOCUS. ALIGNMENT. We are strengthening our structure to make our new mandate possible.

Message from the Chair

Armed with an expanded mandate, a new leadership team and the confidence of our shareholder, Hydro is poised to take its place as an energy leader for the people of this Province. This past year marked the beginning of change and an expanded focus for the company.

Hydro's new mandate positions us to pursue energy-related business opportunities for the Province. From the Lower Churchill and wind generation, to new business developments and oil and gas, Hydro is positioning itself to become a significant driver for economic growth in Newfoundland and Labrador.

It takes vision and courage to evoke change. I am proud that our shareholder has the foresight and vision to recognize the opportunities presented by our energy resources and has empowered Hydro to seize these opportunities for the benefit of all Newfoundlanders and Labradorians. I am also pleased to lead Hydro's professional and experienced Board of Directors. We are well situated to fulfill the expectations of our shareholder.

The responsibility for our progress rests on the capable and talented shoulders of the organization's new President and CEO, Ed Martin. Since joining Hydro in August 2005, his energy, vision and ability to connect with the people who work at Hydro has resulted in a renewed passion about the future. He has refocused and refreshed Hydro, aligning people and positions, shareholder responsibility and

RESPONSIBILITY. LEADERSHIP. ENERGY. ENTHUSIASM.

corporate vision. His leadership, and the stellar team with which he works, is one of Hydro's greatest assets.

Hydro's core business – generating and transmitting energy – will continue to be the cornerstone of the company's and the Province's future. Providing a safe, secure, reliable supply of electricity for households, businesses and industry will be driven by our commitment to operational excellence.

Realizing the full potential of this Province's energy resources for our people is an exciting challenge. Hydro, through strong leadership, and employee commitment is well positioned to meet this challenge.

Dean MacDonald
Chair, Board of Directors

We are striving to provide exceptional value to all energy consumers through operational excellence.

success.

Message from the CEO

This has been a transitional year for Hydro, as our shareholder provided us with a new mandate to grow our business and seek out opportunities in areas including Labrador hydro developments, alternative energies, and oil and gas. We are also leading, on behalf of the Province, a review of development options for the Lower Churchill hydro resource.

Our new mandate challenges us to broaden our thinking to include many areas that were traditionally outside Hydro's realm. The focus of Hydro's leadership team is to harness those opportunities in a disciplined manner that is safe, well planned and executed, and provides the greatest benefits to Newfoundland and Labrador.

Since arriving at Hydro in late summer 2005, I have come to appreciate one of our key world-class resources – the talented men and women who work for this company. Each and every day, in hundreds of different ways, our employees contribute to the well-being and prosperity of this Province. From our engineers and system planners, to our customer service representatives and maintenance teams, Hydro's people are capable, committed and enthusiastic. Our people will continue to focus their efforts to achieve the highest standards of performance in each of our four lines of business to position Hydro as a leader in the energy sector.

Over the coming years we will be turning a corner in the history of the company and heading in a new, robust direction. To ensure our success we will need alignment and support from all our people.

We will place a renewed effort on building a strong relationship with the International Brotherhood of Electrical Workers (IBEW) Locals 1615 and 2351. Their members, the majority of our front-line employees, are critical to the success of our operations. I am optimistic that a new approach of increased communication, engagement and dialogue will benefit all of us as we drive towards a stronger company and a bright future.

As an employer, we are facing an increasing number of retirements throughout the company, but in particular, in the trades and technical professions. This will require a significant effort to ensure we are well-equipped with the right people with the right skills and talents to fulfill our long-term plan.

Achieving our new mandate also requires strong leadership at every level of the company. Hydro will strengthen its leadership development efforts to ensure we maintain a clear and committed focus on our long-term vision. A significant part of providing strong leadership is a continued dedication to providing a safe work environment for our employees. We will do this by achieving top-level safety performance.

The future is not without external challenges. The cost of fuel continues to drive the cost of power generation. We are committed to seeking alternative energy sources for thermal generation, in an effort to minimize our reliance on fuel. Through Hydrowise, our energy

conservation program, we will increase our efforts to educate all electrical consumers, province-wide, on the role they play in reducing their energy consumption.

In 2005, we invested over $47 million to ensure a safe and reliable provincial electrical system. We will continue to strategically invest in the maintenance and upgrades of our assets to ensure we maintain their integrity and operational performance. We will also continue to invest in future developments.

Every day, Newfoundlanders and Labradorians see the outcome of our daily work whenever they turn on their lights, cook their dinner and heat their homes. However, Hydro's role in this Province extends much more broadly. The availability of reliable power at a reasonable cost can attract businesses to this Province; impact how we earn our living, and ultimately, how prosperous we can be as a society. Harnessing the potential of the energy sector is crucial for our collective, long-term success.

Hydro has established an ambitious path forward. Our core business, however, will remain the delivery of safe, reliable generation and transmission of energy. Our people are experts in this business and we will continue to focus on improving our operations, optimizing our performance and achieving operational excellence. We have also expanded our thinking to capture the full potential available to the company by applying our experience and knowledge to other opportunities in the energy sector.

I would like to thank the Board of Directors and our shareholder, the Province of Newfoundland and Labrador, for their support of the company's new direction. I also thank all Hydro employees for their commitment and belief that we can do more for the people and the Province of Newfoundland and Labrador.

Ed Martin
President and CEO

We are committed to being a safety leader.

customer-focus.

Regulated Operations

For more than 50 years, Hydro has played an integral role in the development of all aspects of life in this Province. From its original mandate to complete the electrification of Newfoundland and Labrador, to its present day status as the provider of more than 80 per cent of the electrical energy required in the Province, Hydro's day-to-day work is vitally important in the daily lives of Newfoundlanders and Labradorians. The core regulated operations of generating and transmitting energy for domestic use on the island and in Labrador is performed with pride by Hydro's dedicated and hard-working employees.

To meet the energy requirements of island consumers, Hydro, like most utilities in Canada, relies in part upon fossil fuels to generate electricity. The rising cost of crude oil, which impacts individuals and businesses across the globe, continues to increase the cost of electricity generation for consumers. Since 1995, the price of fuel has increased approximately 175 per cent affecting electricity rates in an unprecedented manner.

In 2005, Hydro produced 23 per cent of its electrical energy on the island from fuel, burning over 2.1 million barrels at the Holyrood Generating Station.

To help offset thermal generation, in December 2005, Hydro issued a request for proposals for 25 MW of cost-effective, wind energy. This generation source, which is expected to be on stream by 2008, has the potential to displace up to 140,000 barrels of fuel annually. Through Hydrowise, Hydro will work with customers, our shareholder and other community partners to promote conservation to all electrical consumers.

Hydro's commitment to providing least-cost reliable energy, in a safe and environmentally-sound manner, is fundamental to all its operations. For example, late in 2005, the decision was made to start burning cleaner fuel at the Holyrood Generating Station in 2006. The change will mean a reduction in sulphur dioxide emissions by 50 per cent and particulate by 40 per cent.

System reliability is paramount at Hydro. To minimize fuel consumption, the company uses hydro generation as much as possible for the benefit of consumers.

Over the past five years, during the peak generating season from December to March, the company operated its hydro facilities on the island with an average availability of 98 per cent. Transmission and distribution system reliability improved in 2005 and both the number and length of power outages decreased.

In September 2004, Hydro began purchasing wind energy from Frontier Power Systems, a non-utility generator in the isolated community of Ramea on the South Coast of Newfoundland. The community is the first of its kind in Canada to have a medium penetration

"At Hydro, we are focused on continually improving our safety and environmental performance to provide customers with reliable and least-cost energy."

– Jim Haynes, Vice-President, Regulated Operations

wind-diesel system. In 2005, Hydro purchased over 418,000 kilowatt hours of wind energy, approximately 10 per cent of Ramea's annual energy requirement.

The company received several commendations for its Granite Canal Hydroelectric Development including the 2005 Outstanding Stewardship of America's Rivers Awards from the National Hydropower Association. The company was recognized for its Granite Canal Fish Habitat Compensation Facility that balances electricity production with the protection of local fish species and their habitat. The facility also received the Ecologo™ Certification, which acknowledges that the electricity generated is renewable and has a low environmental impact.

Hydro continues to invest significantly in upgrades to its system to ensure continued safety and reliability. In 2005, Hydro invested over $47 million in capital upgrades focused on continued performance and reliability. This expenditure included some key projects at the Holyrood Generating Station, specifically the replacement of the unit two stack liner and distributed control system.

Hydro serves 35,000 customers directly in 220 rural communities throughout Newfoundland and Labrador. In 2005, 93 per cent of Hydro's direct customers said they were satisfied with the company's performance.

The future of our regulated operations will be firmly focused on improving our safety performance and maintaining our environmental commitment while providing our customers with least-cost, reliable power through operational excellence.

We are ensuring our team of employees are motivated and strongly committed to our success and future direction.

Churchill Falls Operations

In 1972, the world's largest underground powerhouse opened in Churchill Falls, Labrador. One of the biggest construction projects ever undertaken in Canada at the time, the Churchill Falls project remains one of the wonders of the engineering world. The project was completed ahead of schedule and within budget despite the harsh environment and remote location. Over five years of field work by 6,300 workers culminated in first power being delivered on December 7, 1971, six months ahead of the contract date.

Operational excellence has been the keystone of this world-class facility since that day. As well, the prevention and control of occupational injury and illness, property damage, security breaches and pollution are integrated into every facet of plant management and operations.

Today, 11 turbines harness the power of the massive Churchill River, with a capacity of 5,428 MW. We are powering millions of homes in North America. At peak operations, the plant has the potential to generate energy equivalent to burning 54 million barrels of oil annually.

Approximately 220 dedicated employees keep the Churchill Falls Generating Station operating efficiently year round with their primary focus being safety. CF(L)Co works hard to ensure that the men and women who work at Churchill Falls, as well as their families, are comfortable. The town centre complex includes all the amenities of the community: a school, hotel, theatre, library, bank, post office and recreational facilities. The centre is a focal point for the community, which today has a population of over 650 people. The company continues to invest in the community and in 2005 four new housing units were added, contributing to improved accommodations.

"The size and magnitude of Churchill Falls is truly awesome. This engineering marvel is operated by a team of passionate and dedicated employees, producing electricity for over three million homes."

– Andrew MacNeill, General Manager, CF(L)Co

The Churchill Falls Generating Station produced over 33 terrawatt hours of electricity in 2005, and the bulk of that energy was sold to Hydro-Québec through a long-term power purchase contract set to expire in 2041.

Since 1999, CF(L)Co has entered into a Guaranteed Winter Availability Contract (GWAC) with Hydro-Québec. This contract has focused CF(L)Co on delivering 100 per cent availability for five winter months each year to maximize revenue from the contract. This requires the company to execute a comprehensive maintenance program over the remaining seven months of the year to ensure maximum up time during the GWAC period. Over the last five years, CF(L)Co has consistently reached its availability targets, more than 98 per cent annually.

CF(L)Co is currently reviewing its long-term maintenance philosophy to ensure it sustains its current high level of reliability and asset performance. The company will be using experts in

site operation and design, combined with detailed condition assessment of the major assets to determine its future approach. The goal remains to optimize the remaining asset life, while prudently planning for asset replacement or overhaul.

Meanwhile, the company is continuing with significant capital intensive programs that enhance plant reliability. These include the dyke and dam enhancements, replacement of several bridges on roads required for dyke maintenance, and replacement of the Supervisory Control and Data Acquisition (SCADA) system.

On the environmental front, the company is continuing to replace insulating oil in the underground transformers with biodegradeable environmentally-friendly oil, and systematically replacing wicket gate grease with environmentally-friendly grease and reducing the greasing frequency. There has also been considerable cleanup of construction debris at various CF(L)Co and TwinCo sites. The main site cleanup is completed, however, cleanup will be ongoing for a number of years at other locations that are smaller and more remotely located.

The expertise at Hydro gained from safely and effectively operating one of the world's largest hydroelectric generating stations for over 30 years equips the company to tap the potential of other Labrador hydro resources and pursue new energy sector opportunities.

opportunities.

We are focused on achieving sanction for the Lower Churchill Project.

Lower Churchill

The development of the Lower Churchill hydro resource is one of the most exciting opportunities facing Hydro. With the firm backing of its shareholder, the company has a mandate to deliver a project that will maximize benefits for the Province.

The potential of the Lower Churchill resource – the lowest cost, undeveloped hydro resource in Canada – is immense. Combined, Gull Island (2,000 MW) and Muskrat Falls (824 MW) have the capacity to power 1.5 million homes. This much needed source of clean, renewable energy would allow Newfoundland and Labrador to play an important part in meeting growing energy demands and reducing Canada's greenhouse gas emissions.

The timing is favourable for this development. Market demands in central Canada and the United States continue to grow and assets in these markets are aging. Consumers and energy distributors in these regions are seeking a reliable and clean energy supply. As well, generation sources from fossil fuel, particularly oil and gas, have substantially high costs, adding to the value of a long-term, secure supply of power such as Lower Churchill.

In early 2005, 25 proposals were received through an open expression of interest process for the development of the Lower Churchill. After a comprehensive review, three development proponents with strong credentials were selected to move on to phase two of the process. These included: a consortium of Hydro-Québec, the Ontario Energy Financing Corporation and SNC Lavalin; TransCanada Corporation; and, the Tshiaskueshish Group, a consortium of MacQuarie North America, Peter Kiewit Sons Co. and the Innu Development Limited Partnership.

Further, the option of a Newfoundland led project is being given primary consideration. In view of that priority option, government directed Hydro to apply to Hydro-Québec TransÉnergie for transmission service to transmit Lower Churchill power from the Labrador/Québec border to markets in Québec, Ontario, the Maritimes and the northeast United States.

Much of 2006 will be focused on assessing the economic, financial and technical feasibility of the options with proponents having to demonstrate what value they bring to the development in the areas of risk management, technical expertise, market options and financing. This process could eventually lead to detailed commercial negotiations.

First power is a decade away. However, like any major development project of this magnitude, there is significant work ongoing. Hydro is working cooperatively with the Innu Nation that has a registered land claim including the project area. The company is also committed to a rigorous and comprehensive environmental assessment process. To this end, field work is continuing this year and preparations are being made for submission of an Environmental Impact Statement in 2007. Project sanction is expected by 2009.

The expertise and experience Hydro has gained in a half-century as the prime generator of energy for this Province will be utilized to deliver the best project for Newfoundland and Labrador.

"In our planning process, we are moving forward on multiple fronts. We are assessing development options; we are in discussions with the Innu Nation; and we are laying the groundwork for the comprehensive environmental assessment process."

– Gilbert Bennett, Vice-President, Lower Churchill Development

Alternatives.

We are committed to being an environmental leader.

New Business Development

With more than 50 years of experience and the expertise of a talented team of professionals, Hydro is well positioned to maximize the potential of other business opportunities.

These opportunities may lie in alternative energy sources such as wind generation; in the development of hydro capacity on Labrador rivers; within the oil and gas sector; or, in other energy-related businesses. All new opportunities Hydro pursues will build on industry best practices, and the company intends to be a leader in the energy sector for our Province and a strong economic contributor.

Newfoundland and Labrador has a world-class wind resource. The challenge ahead for Hydro is to ensure that wind generation is incorporated into the island interconnected system in a reliable manner, and to investigate the vast potential that exists in Labrador in terms of export and sale of energy generated by the power of the wind.

The first steps towards harnessing our world-class wind resource have been taken. In 2005, 13 potential projects were submitted in the first phase of a call for proposals for 25 MW of wind generation for the island.

The development of the Lower Churchill will also help to provide a clearer picture of the potential for other energy developments in Labrador. Continued rising demand for energy in North America will mean that other projects may become more viable and attractive over time.

Hydro's shareholder has also given the company direction to explore opportunities in the oil and gas sector.

EXPERTISE. DARING. FUTURE-FOCUS. PLANNING. SOUND.

"Our approach to creating new business starts with our long-standing skill harnessing the advantages that nature provides. At Hydro, we see ourselves as integrators – capturing our natural advantages, applying creativity and competence, to extract value."

– Jim Keating, Vice-President, Business Development

Hydro will approach any opportunity with sound business planning and thorough economic and risk analysis. The company is exploring opportunities ranging from an equity position in future projects to participating in the development of the natural gas business, over the longer term.

The core business for the past half-century has prepared the company to take on new challenges. Hydro has built a great capacity in terms of engineering expertise and successful project execution in harsh environments. Not only does that give Hydro a distinct advantage as it pursues business opportunities in electrical energy generation and the oil and gas sector, but it also opens up the potential to use its talents in other energy-related businesses. Hydro engineers could provide valuable knowledge and expertise to many development projects around the world. How this expertise will add to Hydro's business portfolio is currently being explored.

Management's Discussion and Analysis

Management's Discussion and Analysis highlights the primary factors that have an impact on the financial results and operations of the company. Certain factors that may impact future operations are also discussed. Such comments will be affected by, and may involve, known and unknown risks and uncertainties that may cause the actual results of the company to be materially different from those expressed or implied. Those risks and uncertainties include, but are not limited to, major equipment failure, weather, commodity prices, interest and foreign exchange rates, regulatory requirements and general economic conditions. To enhance the shareholder's understanding, certain multi-year historical financial and statistical information is presented.

This discussion and analysis should be read in conjunction with the Newfoundland and Labrador Hydro (Hydro) 2005 audited consolidated financial statements and the accompanying notes.

Hydro is a Crown Corporation, owned by the Province of Newfoundland and Labrador (Province). Hydro generates, transmits and distributes electrical power and energy to utility, residential and industrial customers throughout the Province.

Hydro is the parent company of the Hydro Group of Companies (Hydro Group) comprised of Newfoundland and Labrador Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co), Lower Churchill Development Corporation Limited (LCDC), Gull Island Power Company Limited (GIPCo), and Twin Falls Power Corporation Limited (TwinCo). Hydro has one wholly owned subsidiary, GIPCo as well as a 51% interest in LCDC and a 65.8% interest in CF(L)Co. CF(L)Co is accounted for as a joint venture and has joint control of TwinCo. The Hydro Group's installed generating capacity is the fourth largest of all utility companies in Canada. Generating assets consist of ten hydroelectric plants, including the Churchill Falls facility, one of the largest underground powerhouses in the world with a rated capacity of 5,428 megawatts (MW), one oil-fired plant, four gas turbines and 27 diesel plants.

2005 Net Income and Balance Sheet Highlights

millions of dollars

	Hydro (Unconsolidated)	CF(L)Co	GIPCo	LCDC	Eliminating Entries	Hydro (Consolidated)
2005 Net Income						
Revenue	$ 463.0	$ 70.3	$ -	$ -	$ (0.8)	$ 532.5
Expenses	412.5	48.5	-	-	(0.4)	460.6
Net Income (loss)	$ 50.5	$ 21.8	$ -	$ -	$ (0.4)	$ 71.9
2005 Balance Sheet						
Total Assets	$ 2,121.2	$ 363.1	$ 0.1	$ 5.2	$ (285.5)	$ 2,204.1
Liabilities	$ 1,614.3	$ 82.9	$ -	$ -	$ (0.1)	$ 1,697.1
Equity	506.9	280.2	0.1	5.2	(285.4)	507.0
Total Liabilities and Equity	$ 2,121.2	$ 363.1	$ 0.1	$ 5.2	$ (285.5)	$ 2,204.1

FINANCIAL HIGHLIGHTS

Net income for 2005 increased 7% from $67.2 million to $71.9 million over the previous year. The increase was due mainly to higher revenues partially offset by higher operations and administration expenses.

Cash from operations increased 33% from $131.1 million to $173.9 million over the previous year. The increase was due mainly to collection of balances owing under the Rate Stabilization Plan (RSP). The RSP provides for the deferral of expense variances resulting from changes in heavy fuel oil prices, levels of precipitation and load.

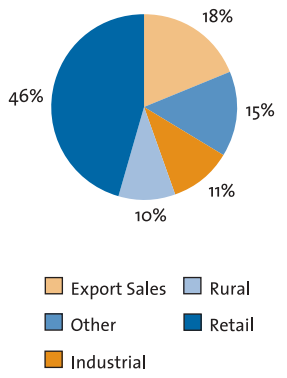
COMPOSITION OF REVENUE AND EXPENSE

Hydro's revenue consists of sales of electricity to several large industrial customers in the Province and over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Hydro also supplies over 90% of the energy required by Newfoundland Power, an investor-owned utility that distributes electrical power to the balance of the population on the island portion of the Province. Export sales consist of power generated at Churchill Falls and sold to Hydro-Québec. The majority of these sales are made directly by CF(L)Co to Hydro-Québec at rates set under a long-term power contract. The remainder is sold to Hydro-Québec by Hydro at negotiated rates.

The company's major expense categories consist of fuel and purchased power, operating, maintenance and administration, finance charges and depreciation.

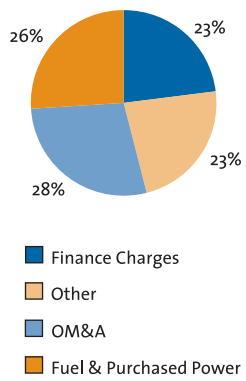
2005 Revenue

Total Revenue: $532.5 million



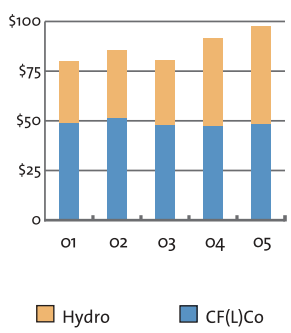
2005 Expense

Total Expense: $460.6 million

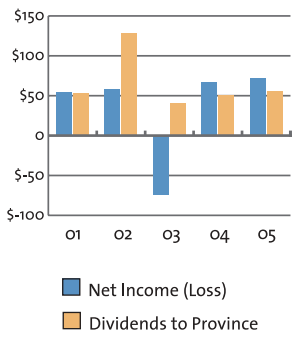


Five-Year Summary of Export Sales

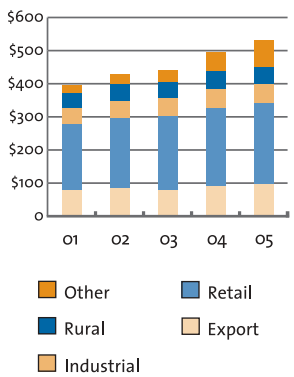
($ millions)



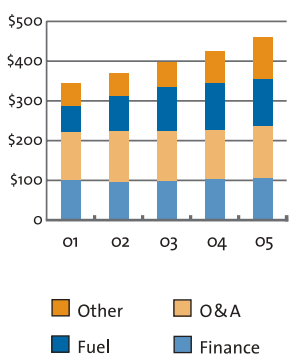
Five-Year Summary of Net Income (Loss) and Dividends to Province
($ millions)



Five-Year Summary of Revenue
($ millions)



Five-Year Summary of Expense
($ millions)



NET INCOME

Hydro's consolidated net income was $71.9 million in 2005, an increase of $4.7 million from 2004.

REVENUE

Total revenues increased by $39.0 million or 8% from 2004 primarily due to recoveries under the RSP and increased revenues stemming from rate increases applied to wholesale, industrial and export sales.

DIVIDENDS

During 2005, Hydro paid dividends of $55.8 million to its shareholder compared to $50.6 million in 2004. These payments are primarily the result of earnings associated with export sales. In early 2006, Hydro, in consultation with the Board of Directors and its shareholder, suspended projected dividend payments totalling approximately $54 million in the upcoming 2006 fiscal year to provide cash flow to facilitate growth initiatives.

EXPENSES

Total expenses increased by $34.3 million, or 8% from 2004, primarily due to an increase of $22.3 million related to amortization of costs in the RSP and an increase of $7.4 million in operations and administration costs.

Hydro pays various fees, taxes and other charges as indicated below:

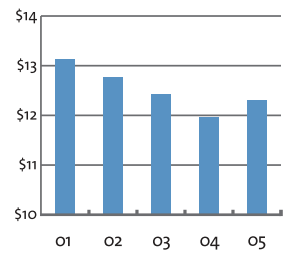
Fees, Taxes and Water Rentals (millions of dollars)

Payment	Recipient	2005	2004
1% Debt Guarantee Fee	Government of NL	$ 14.4	$ 14.6
Payroll Tax	Government of NL	1.2	1.4
Rentals and Royalties	Government of NL	5.4	5.2
Municipal Taxes	Various NL Municipalities	1.4	1.2
Total		$ 22.4	$ 22.4

OPERATIONS AND ADMINISTRATION

While operations and administration expenses were up slightly over 2004, in 2005 they continue to represent 25¢ out of every dollar of revenue. When viewing Hydro's operating results only, exclusive of subsidiary activity, Hydro's controllable unit cost has increased. This is largely due to increased operations and administration expenses coupled with a decrease in overall energy deliveries. Increases in operations and administration costs were largely due to increased maintenance costs. A major overhaul was performed on a unit at the Holyrood Generating Station. There were also increased maintenance costs associated with diesel overhauls in our rural operations and with the maintenance of CF(L)Co assets. The decline in energy deliveries was largely due to lower industrial load caused by lower sales to customers in the pulp and paper industry.

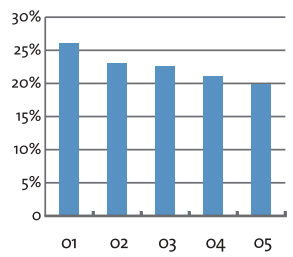
Controllable Unit Cost
($/MWh)



FINANCE CHARGES

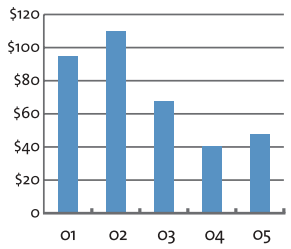
Interest expense, including the guarantee fee, increased by $2.2 million to $105.9 million, primarily due to lower interest earned. Lower interest earned was largely due to lower RSP balances and lower capital gains realized within the sinking funds. The effect of these factors was partially offset by lower interest expense associated with declining debt in CF(L)Co and higher interest capitalized.

Five-Year Summary of Finance Charges as a Percentage of Revenue



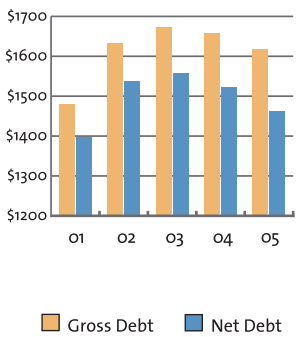
Five-Year Summary of Capital Expenditures

($ millions)



Debt Outstanding at December 31

($ millions)



CAPITAL EXPENDITURES

In order to ensure a safe, reliable and cost-effective supply of electricity for its customers, Hydro invested $47.7 million in various capital projects during 2005 compared to $40.1 million in 2004. Major capital investments in 2005 included:

- $8.1 million for the improvements to distribution systems along with additions for new customers;
- $5.3 million for the potential development of hydro projects in Labrador;
- $3.2 million for improvements at various hydraulic generation stations;
- $2.7 million for upgrades to transmission systems; and,
- $2.1 million for replacement of the Energy Management System.

BORROWING AND DEBT

There were no new long-term borrowings during 2005. Hydro's net debt decreased to $1,462.4 million at December 31, 2005, from $1,521.2 million at December 31, 2004 as a result of: scheduled principal repayments on long-term debt of $32.2 million; a decrease of $7 million in promissory notes outstanding; and, an investment in sinking funds of $19.6 million. In 2006, Hydro expects to issue new long-term debt, necessitated mainly by the maturity of the Series AC debenture. This debenture has a face value of $200 million and carries a coupon rate of 5.05%. Hydro is permitted to borrow up to $300 million in promissory notes as per Order-in-Council. At December 31, 2005, promissory notes outstanding were $151 million.

ACCOUNTING STANDARDS

In 2005, Hydro implemented Accounting Guideline 19, *Disclosures by Entities Subject to Rate Regulation*. Note 3 to the audited consolidated financial statements attached, has been prepared in compliance with this new guideline.

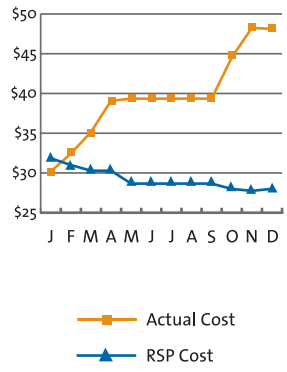
RATE STABILIZATION PLAN (RSP)

The difference between the cost of fuel consumed and the cost upon which rates are based accumulates in the RSP. Balances which accumulated prior to December 31, 2003, are being recovered over a four-year period which commenced in 2004. As of December 31, 2005, $104.9 million remains to be recovered.

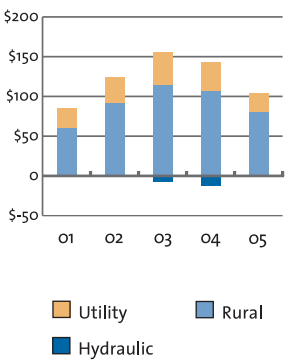
Subsequent balances accumulating in the RSP are recovered in the following year, with the exception of variations relating to unexpected levels of precipitation (hydraulic variation), which will be recovered or refunded at a rate of 25% per year. Additionally, a fuel rider is calculated based on the forecast fuel price and is added to, or subtracted from, the electrical rates that are in effect.

During 2005, the activity in the RSP resulted in a long-term hydraulic balance owing to customers of $10.6 million, and an outstanding balance owing to customers for the other components of the plan of $1.3 million, which is to be refunded during 2006.

2005 No.6 Fuel Cost
($/barrel)



RSP Plan Balances
($ millions)



PERFORMANCE MEASURES

Financial Performance Indicators (Hydro only)	2005	2004	2003
Return on Equity (%)	24.3	23.4	8.6
Debt to Capital (%)	85	86	86
Interest Coverage Ratio	1.41	1.39	1.15
Controllable Unit Cost ($/MWh)	12.31	11.97	12.42
Non-Financial Performance Indicators (Hydro only)	**2005**	**2004**	**2003**
Weighted Capability Factor	84.90	89.76	87.83
Thermal Conversion Factor (Holyrood)	621.97	632.27	634.92
SAIFI – Transmission	1.52	1.84	2.59
SAIFI – Distribution	5.83	5.90	7.86
SAIDI – Transmission	98.5	98.77	222.34
SAIDI – Distribution	8.80	11.17	11.90
All Injury Frequency Rate	2.21	1.43	2.10
Residential Customer Satisfaction Index	8.2	7.9	7.9
Commercial Customer Satisfaction Index	8.3	8.1	8.1

Description of Performance Indicators

Return on Equity – Net Income/Average Equity.

Debt to Capital – Year-end debt balance expressed as a percentage of the total corporate financing structure.

Interest Coverage Ratio – The extent to which income before financing charges is able to cover the company's interest obligations.

Controllable Unit Cost – Controllable Corporate Operating, Maintenance and Administrative Cost/energy deliveries megawatt hour (MWh).

Weighted Capability Factor – Percentage of time that units are available to supply load.

Thermal Conversion Factor (Holyrood) – An indicator of thermal plant efficiency. Net kilowatt hour (kWh) generated/barrels of No. 6 fuel consumed.

System Average Interruption Frequency Index (SAIFI) – Total number of sustained outages/total number of delivery points or customers. An outage is sustained if over 1 minute in duration.

System Average Interruption Duration Index (SAIDI) – Total duration (minutes) of all outages/number of delivery points or customers.

All Injury Frequency Rate – [(number of disabling injuries + number of medical aid injuries) * 200,000] / hours worked. It measures the frequency with which injuries occur.

Customer Satisfaction Index – The weighted average of satisfaction ratings of the service attributes, based on annual rural residential customer survey.

Hydro continues to focus on corporate performance by tracking progress against several key performance indicators (KPI). The measures above reflect Hydro's operating results only, exclusive of subsidiary activity.

Return on equity and the interest coverage ratio increased from 2004. This was primarily due to a higher net income arising from higher revenue, which was partially offset by higher operations and administration costs.

In 2005, Hydro recorded an overall improvement in its operating performance relative to 2004, as measured through its various reliability KPIs. There was an improvement in Hydro's SAIDI (duration of outages) and SAIFI (number of outages) for the operation of Hydro's transmission and distribution assets. As expected, the

weighted capability factor had lower performance in 2005 because units were unavailable during activities under the Asbestos Abatement Program at the Holyrood Generating Station. In terms of operating KPIs the decrease in the thermal conversion factor was largely the result of: high reservoir conditions; high production levels from hydroelectric assets; and, lower load conditions late in the year owing to warm weather and the loss of the load associated with a major industrial customer.

Hydro will strive for improvements in its safety program to address the increase in the all injury frequency rate. There were improvements in the customer satisfaction indices.

REGULATION

On January 1, 2005, Hydro implemented the initial phase of a demand-energy rate structure for Newfoundland Power which was approved by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) in December 2004. The demand-energy rate, which is to be fully phased in over three years, replaces the energy-only rate and will result in a more effective wholesale price signal, potentially conserving capital and natural resources. On December 14, 2005, the PUB approved the second phase of the demand-energy rate to be charged to Newfoundland Power effective on January 1, 2006.

On January 12, 2005, the PUB approved Hydro's request to treat the costs associated with the Asbestos Abatement Program at the Holyrood Generating Station, at an estimated cost of $8.7 million ($10.4 million including financing), as a major extraordinary repair. As such, Hydro accumulates and amortizes each year's actual expenses for the Asbestos Abatement Plan, together with interest, for a five-year period, to be carried out for a three-year period which commenced in 2005.

On December 13, 2005, the PUB approved rates for the final year of a three-year phase-in of rate changes affecting Hydro's Isolated General Service customers, and the third year of the five-year phase-in of the implementation of uniform rates for customers served by Hydro on the Labrador Interconnected System. Rates for both customer groups became effective on January 1, 2006.

SAFETY AND HEALTH

The safety and well-being of its workforce is a priority for Hydro. In keeping with the expanded mandate, Hydro is embarking upon a revitalization of its comprehensive safety and health program to ensure that it meets or exceeds industry best practice. Our goal is to establish Hydro as a Canadian leader with respect to safety and health within the next five years.

HUMAN RESOURCES

Effective and progressive human resource management practices which ensure our ability to recruit and retain a highly qualified workforce, will continue to play a key role in Hydro's success. The importance of this is highlighted and reinforced by the fact that 25% of Hydro's workforce will be eligible to retire over the next five years; over the next 10 years this percentage exceeds 40%. Other organizations in the utility sector are facing the same demographic challenges, and Hydro's ability to successfully compete for talented people in the years to come will be heavily dependent on our reputation as a preferred employer.

A review and enhancement of Hydro's graduate development and apprenticeship programs in 2005 was an important first step in addressing our longer-term succession planning requirements. Other strategies will be developed to complement these programs and to ensure the systematic and timely development and recruitment of people and key skills. Progress has also been made in reviewing our approach to training and employee development, and the implementation of a new corporate learning strategy is a short-term goal for Hydro.

Another important area of focus is improving Hydro's competitive position in the utility sector relative to employee compensation. Negotiated contract settlements within the Atlantic Canadian utility sector, combined with a provincially mandated, wage freeze at Hydro, have caused this to be a growing issue. Efforts to address this concern and achieve a more competitive position in the labour market in which Hydro competes will continue.

INFRASTRUCTURE AND TECHNOLOGY

Hydro's generation and transmission facilities were constructed primarily during the 1960s and 1970s. Many facilities are now approaching 40 years of age and require increasing amounts of maintenance to maintain acceptable levels of reliability. Significant capital investment is also required each year to ensure that facilities and equipment are upgraded, replaced or installed to meet the increasing demand for safe and reliable electrical energy for our customers. As well, increased environmental expectations and regulations have spurred increased capital investment, as well as operational costs.

New technologies and processes in many areas of the business may affect the way the company operates in the future and Hydro will continue to integrate new equipment and processes in a cost-effective business focused manner.

Renewable energy sources, such as wind, may also offer potential for cost-effective generation of power as the technology becomes mature and costs decrease.

ENVIRONMENT

Hydro continues to maintain its Environmental Management Systems (EMS), encompassing all facets of the company's business, to provide a structure for: prevention of pollution; compliance with legislation; continual improvement; and, other environmental guiding principles appropriate to our operations. These EMS are registered as compliant with the requirements of the ISO 14001 EMS standard by the Quality Management Institute, who undertake annual audits to confirm compliance.

Hydro has recently focused on assessing potential concerns with air emissions from thermal generation components of our operations with a goal of clarifying the validity of such concerns and planning changes in our operations, if required. At the Holyrood Generating Station, the company has:

- taken an initiative to reduce air emissions from Holyrood by reducing the sulphur content of the Bunker "C" used from a maximum of 2% to a maximum of 1%. This will result in reduced emission rates for sulphur dioxide, acid aerosols and particulate matter;
- installed a fifth ambient air monitoring station;
- added fine particulate and nitrogen oxide monitoring at all five monitoring sites;
- extended and enhanced work on a human health risk assessment associated with air emissions to include data from the new monitoring initiatives and a peer review of the report; and,
- issued a request for proposals for 25 MW of cost-effective wind energy.

We have also conducted air dispersion modelling of emissions from prime power diesel generation facilities and plans have also been developed to undertake ambient air monitoring for nitrogen oxides at one prime power diesel plant location.

Hydro continues to implement an Environmental Site Assessment Program which is designed to assess its land holdings for contamination and to systematically identify and manage Hydro's environmental liability over time. The program provides for standardized site assessment processes, identification of risks and, if deemed necessary, remediation requirements.

The Holyrood Generating Station must report annual greenhouse gas emissions under federal government legislation for 2005 emissions. While the details of how Kyoto Protocol compliance is to be achieved are uncertain at this time, they will affect Hydro operations and costs. Hydro has identified initiatives for future renewable energy resources and is maximizing the efficiency of existing renewable energy generation to help minimize thermal power generation requirements.

RISK MANAGEMENT

Hydro operates in an environment with various forms of business and financial risk. The company's risk management activities are focused on those exposures that can significantly impact our corporate goals.

Hydro utilizes risk management practices to ensure protection of the company's physical and financial assets. The company's risk management practices are continually updated to reflect current trends in risk control, risk financing and risk transfer to the general insurance marketplace. Hydro's main business risks include: major damage to critical assets; interruption of service; and, liability to third parties arising from property damage, bodily injury or death. To eliminate or mitigate such risks, the company has: developed regular maintenance and inspection programs for all assets; initiated redundancy of critical assets, as required; and, completed loss analysis of all incidents to develop loss-prevention programs.

The corporate insurance program, covering all assets and specified liabilities, is reviewed and negotiated with Insurers annually. The review focuses on exposures to loss, adequacy of coverage limits, deductible levels, self-insured exposures and loss history. On completion of the annual review, strategies are developed to ensure provision of optimal coverage terms at a competitive cost. The company is currently in the process of developing and implementing business continuity plans for events that could cause a complete disruption of essential service for an extended period of time. These plans will be utilized to identify and categorize potential catastrophic events and document procedures to ensure provision of minimum essential service until such time as full service can be restored. During the past year, the

company engaged a consultant to complete a security assessment of critical infrastructure. Hydro will utilize the assessment data to develop risk management techniques to control potential exposures and increase security at critical facilities.

Financial risks include changes in interest rates and fluctuation in foreign currency exchange rates and commodity prices. The company manages its exposure to interest rates through ongoing benchmarking against key indices, coupled with sensitivity analysis to assess risk exposure. Hydro's fixed and floating borrowing program is formulated with a view to an acceptable risk profile. Current guidelines, as approved by Hydro's Board of Directors, limit floating rate debt to a maximum of 19% of Hydro's total debt. In 2006, Hydro's floating rate debt is not expected to exceed 14% of total debt at any time during the year. The company mitigates its foreign exchange exposure through a diversified approach that includes the periodic use of forward currency contracts. Commodity price exposure is mitigated in large measure through the operation of the RSP.

BUSINESS PROCESS IMPROVEMENT

Hydro's approach to its program of business process review is now part of a broadened corporate focus on organizational effectiveness. Benchmarking best practices, and continuous improvement methodologies will drive all areas of the company.

OUTLOOK FOR 2006

Earnings are expected to be relatively unchanged in 2006. During 2005, one of Hydro's major island industrial customers ceased operations; however, the earnings impact in 2006 is expected to be minimal given the savings in related fuel costs and the operation of the RSP. Total RSP balances owing to Hydro from customers primarily related to deferred fuel charges in the RSP are forecast to decline to $72.9 million by the end of 2006, from $93.1 at the end of 2005. Forecast RSP balances incorporate fuel charge estimates based on burning cleaner fuel at the Holyrood Generating Station. The inclusion of the associated added fuel costs as a component of the RSP is currently awaiting PUB approval. The 2006 approved capital budget for Hydro only, is $42.6 million and $15.7 million for CF(L)Co.

Management Report

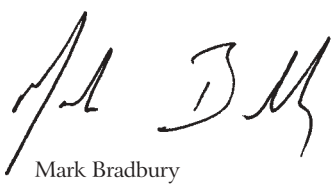
The accompanying consolidated financial statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 14, 2006. Financial information presented elsewhere in the Annual Report is consistent with that in the financial statements.

Management maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for the appropriate delegation of authority and segregation of responsibilities. An internal audit department independently evaluates the effectiveness of these internal controls on an ongoing basis, and reports its findings to Management and to the Audit Committee of the Board of Directors.

The responsibility of the external auditor, Deloitte & Touche LLP, is to express an independent, professional opinion on whether the financial statements are fairly presented in accordance with Canadian generally accepted accounting principles. The Auditors' Report outlines the scope of their examination and their opinion.

The Board of Directors, through its Audit Committee, is responsible for ensuring that Management fulfills its responsibility for financial reporting and internal controls. The Audit Committee meets regularly with Management, the internal auditors and the external auditors to satisfy itself that each group has properly discharged its respective responsibility and to review the financial statements before recommending approval by the Board of Directors. The internal and external auditors have full and free access to the Audit Committee, with and without the presence of Management.



Mark Bradbury
Vice-President, Finance and Chief Financial Officer *(Acting)*

Edmund Martin
President and Chief Executive Officer

Auditors' Report

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2005, and the consolidated statements of income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Chartered Accountants
St. John's, Newfoundland and Labrador
Canada
February 14, 2006

Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2005**	2004
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,672.8**	2,653.5
Less contributions in aid of construction	**106.5**	106.9
	2,566.3	2,546.6
Less accumulated depreciation	**851.0**	816.3
	1,715.3	1,730.3
Construction in progress	**66.3**	54.2
	1,781.6	1,784.5
Current assets		
Cash and cash equivalents	**3.0**	4.0
Short-term investments	**6.1**	-
Accounts receivable	**67.9**	67.2
Current portion of long-term receivables (Note 3)	**42.7**	41.5
Current portion of rate stabilization plan (Note 3)	**0.1**	8.6
Fuel and supplies at average cost	**59.7**	48.3
Prepaid expenses	**2.3**	2.0
	181.8	171.6
Long-term receivables (Note 3)	**64.7**	97.7
Sinking funds (Note 10)	**85.8**	72.6
Investments (Note 4)	**5.2**	5.2
Deferred charges (Notes 3 and 6)	**85.0**	85.0
	2,204.1	2,216.6

See accompanying notes

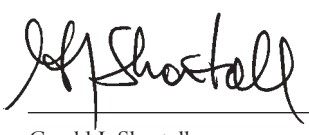
Consolidated Balance Sheet

As at December 31 (millions of dollars)	**2005**	2004
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,174.8**	1,407.6
Current liabilities		
Bank indebtedness	**6.0**	8.0
Accounts payable and accrued liabilities	**59.8**	49.1
Accrued interest	**29.5**	30.3
Long-term debt due within one year (Note 7)	**222.6**	28.4
Current portion of rate stabilization plan (Note 3)	**1.3**	-
Promissory notes (Note 7)	**150.8**	157.8
	470.0	273.6
Rate stabilization plan (Note 3)	**10.6**	5.5
Long-term payable (Note 8)	**0.7**	1.1
Employee future benefits (Note 9)	**38.5**	35.4
Non-controlling interest in LCDC	**2.5**	2.5
	52.3	44.5
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Note 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	96.4
Retained earnings	**370.5**	354.4
	507.0	490.9
Commitments and contingencies (Note 12)		
	2,204.1	2,216.6

See accompanying notes

On behalf of the Board:

Dean MacDonald
Director



Gerald J. Shortall
Director

Consolidated Statement of Income and Retained Earnings

Year ended December 31 (millions of dollars)	**2005**	2004
Revenue		
Energy sales	**453.9**	439.8
Recovery of costs in rate stabilization plan (Note 3)	**56.5**	34.2
Guaranteed winter availability	**16.4**	14.6
Rentals and royalties	**0.3**	0.3
Other	**5.4**	4.6
	532.5	493.5
Expenses		
Operations and administration	**130.8**	123.4
Fuels	**84.5**	83.1
Amortization of costs in rate stabilization plan (Note 3)	**56.5**	34.2
Power purchased	**35.9**	36.1
Depreciation	**47.0**	45.8
Interest (Note 11)	**105.9**	103.7
	460.6	426.3
Net income	**71.9**	67.2
Retained earnings, beginning of year	**354.4**	337.8
	426.3	405.0
Dividends	**55.8**	50.6
Retained earnings, end of year	**370.5**	354.4

See accompanying notes

Consolidated Statement of Cash Flows

Year ended December 31 (millions of dollars)	2005	2004
Cash provided by (used in)		
Operating activities		
Net income	71.9	67.2
Adjusted for items not involving a cash flow		
Depreciation	47.0	45.8
Amortization of deferred charges	4.1	3.7
Rate stabilization plan	14.9	(3.1)
Loss on disposal of capital assets	3.9	1.7
Foreign exchange gain	(0.1)	(0.1)
Other	0.1	-
	141.8	115.2
Change in non-cash balances related to operations		
Accounts receivable	(0.7)	(10.7)
Fuel and supplies	(11.4)	0.2
Prepaid expenses	(0.3)	0.5
Accounts payable and accrued liabilities	13.0	(0.2)
Accrued interest	(0.8)	(0.2)
Employee future benefits	3.1	3.4
Long-term receivable	29.6	21.8
Long-term payable	(0.4)	1.1
	173.9	131.1
Financing activities		
Long-term debt retired	(32.4)	(20.8)
Increase in sinking funds	(19.5)	(21.6)
Foreign exchange loss recovered	1.5	2.7
Decrease in short-term borrowing	-	(1.8)
(Decrease) increase in promissory notes	(7.0)	8.0
Decrease in contributed capital	-	(3.6)
Dividends	(55.8)	(50.6)
	(113.2)	(87.7)
Investing activities		
Net additions to capital assets	(47.7)	(40.1)
Proceeds on disposal of capital assets	0.4	1.1
Increase in short-term investments	(6.1)	-
(Additions) reductions to deferred charges	(4.1)	0.5
Change in accounts payable related to investing activities	(2.2)	(2.3)
	(59.7)	(40.8)
Net increase in cash	1.0	2.6
Cash position, beginning of year	(4.0)	(6.6)
Cash position, end of year	(3.0)	(4.0)
Cash position is represented by		
Cash and cash equivalents	3.0	4.0
Bank indebtedness	(6.0)	(8.0)
		(4.0)
Supplementary disclosure of cash flow information		
Income taxes paid	0.2	0.2
Interest income received	0.3	0.2
Interest paid	111.9	112.0

See accompanying notes

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown Corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited (Twin Falls), are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are subject to rate regulation. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB, which as an agency of the Province, is a related party. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.5%. The effects of rate regulation on the financial statements are more fully disclosed in Note 3.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited (GIPCo), (100% owned) and Lower Churchill Development Corporation Limited (LCDC), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co) and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co subsequent to the effective date of the shareholders' agreement.

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (CF(L)Co Project).

A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from the CF(L)Co Project until 2041. CF(L)Co receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

CF(L)Co holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives CF(L)Co joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project), (Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development), (Note 4).

Twin Falls is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were short-term investments of $6.1 million (2004 - nil) outstanding at December 31, 2005, bearing interest rates of 2.74% to 3.96% (2004 - nil) per annum.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

During 2004, Hydro adopted the recommendations of the Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3110, Asset Retirement Obligations. This new accounting standard requires that the company recognize the fair value of the future expenditures required to settle legal obligations associated with the retirement of capital assets, to the extent that it is reasonably estimable. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *Cont'd*

Capital Assets and Depreciation *Cont'd*

Hydro, GIPCo and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co

CF(L)Co uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Promissory Notes

Promissory Notes bear interest from 2.80% to 3.70% per annum (2004 - 2.10% to 2.86%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. During 2005, a regulated utility customer accounted for 54% (2004 - 53%) of energy sales revenue.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2004 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(i) Under the provisions of the Power Contract CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 3).

Financial Instruments

From time to time, Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

2. CAPITAL ASSETS

millions of dollars	Capital Assets in Service	Contributions in Aid of Construction	Accumulated Depreciation	Construction in Progress
		2005		
Generation Plant				
Hydroelectric	1,358.8	20.5	289.1	0.1
Thermal	231.7	-	180.8	0.8
Diesel	58.5	6.3	26.0	0.1
Transmission and Distribution	734.2	55.1	197.8	2.2
Service facilities	22.0	-	10.4	-
Other	267.6	24.6	146.9	63.1
	2,672.8	106.5	851.0	66.3

millions of dollars		2004		
Generation Plant				
Hydroelectric	1,350.4	20.5	278.2	0.2
Thermal	228.1	-	177.4	-
Diesel	56.8	6.5	24.1	0.4
Transmission and Distribution	730.9	55.1	183.2	0.2
Service facilities	22.0	-	10.1	-
Other	265.3	24.8	143.3	53.4
	2,653.5	106.9	816.3	54.2

Included in the above amounts are CF(L)Co assets in service amounting to $641.9 million (2004 - $639.3 million) which are pledged as collateral for long-term debt.

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process.

Capital Assets and Depreciation

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and depreciated over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower that its cost of debt (8.0%), the amount capitalized is $0.2 million (2004 - $0.2 million) lower and interest expense is higher than that which would be permitted in the absence of rate regulation (Note 11).

Hydro depreciates its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be depreciated using the straight-line method (Note 2).

During 2005, pursuant to Order No. P.U. 7 (2002-2003) Hydro engaged an independent consultant to conduct a depreciation study. The scope of this study included a review of Hydro's depreciation methods as well as a statistical analysis of service life estimates and calculation of appropriate depreciation rates and annual and accrued depreciation balances as at December 31, 2004. Based on the results of this study, management estimates that accumulated depreciation is approximately $170-180 million lower than it would otherwise be, and annual depreciation expense is $10-11 million lower, primarily due to the use of sinking fund rather than straight-line depreciation for hydroelectric and transmission assets.

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to December 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. At December 31, 2005, the unamortized balance was $104.9 million (2004 - $134.0 million). Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25% of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2005, $6.3 million (2004 - $5.9 million) was deferred in the RSP.

Foreign Exchange Losses

The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Notes 6 and 10).

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION *Cont'd*

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the general rate application and hearing, to be amortized over a three-year period, which commenced in 2004. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2005, $0.7 million (2004 - $0.4 million) of amortization was recognized in operations and administration expenses (Note 6).

Deferred Major Extraordinary Repair

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an Asbestos Abatement Program at the Holyrood Thermal Generating Station. This program, which is to be carried out over a three-year period, commenced in 2005. Pursuant to Order P.U. No. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the costs of the Asbestos Abatement Program in the year in which they were incurred. In 2005, $0.1 million (2004 - nil) of amortization was recognized in operating costs, and $3.9 million (2004 - nil) was deferred in relation to the Asbestos Abatement Program (Note 6).

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application (planned for 2006). Hydro intends to seek, and expects to receive, approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs, in the amount of $0.1 million, have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred (Note 6).

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred. At December 31, 2005, the unamortized balance was $0.8 million, (2004 - $ 0.8 million) and is included in accounts payable and accrued liabilities.

4. INVESTMENTS

millions of dollars	**2005**	2004
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (Option Agreement). The purchase price in respect of GIPCo's assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2006.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

5. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2005, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2005.

millions of dollars	**2005**	2004
Current assets	**32.9**	25.1
Long-term assets	**331.8**	338.6
Current liabilities	**24.4**	23.8
Long-term liabilities	**51.7**	66.6
Revenues	**66.4**	63.9
Expenses	**48.6**	47.3
Net income	**17.8**	16.6
Cash provided by (used in)		
Operating activities	**32.1**	33.2
Financing activities	**(19.2)**	(21.0)
Investing activities	**(11.5)**	(5.3)

6. DEFERRED CHARGES

millions of dollars	2005	2004
Debt discount, financing expenses and other	15.1	15.1
Accumulated amortization	12.4	11.3
	2.7	3.8
Regulatory costs	1.8	1.8
Major extraordinary repair	3.9	-
Study costs	0.1	-
Accumulated amortization	5.8	1.8
	4.6	1.4
Net Foreign exchange losses realized	86.3	86.3
Accumulated amortization	8.6	6.5
	77.7	79.8
Net deferred charges	85.0	85.0

7. LONG-TERM DEBT

	Hydro	CF(L)Co	Total	Hydro	CF(L)Co	Total
millions of dollars	2005			2004		
Summary of long-term debt						
Long-term debt	1,331.5	65.9	1,397.4	1,354.8	81.2	1,436.0
Less payments due within one year	208.4	14.2	222.6	13.8	14.6	28.4
	1,123.1	51.7	1,174.8	1,341.0	66.6	1,407.6

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2006	2007	2008	2009	2010
	222.6	22.5	209.1	9.1	44.1

The payments due within one year include sinking fund requirements of $8.2 million (2004 - $10.0 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				2005	2004	
AC	5.05	2001	2006	200.0	200.0	
AA	5.50	1998	2008	200.0	200.0	
V	10.50	1989	2014	125.0	125.0	(a)
X	10.25	1992	2017	150.0	150.0	(a)
Y	8.40	1996	2026	300.0	300.0	(a)
AB	6.65	2001	2031	300.0	300.0	(a)
AD	5.70	2003	2033	125.0	125.0	(a)
Total debentures				1,400.0	1,400.0	
Less sinking fund investments in own debentures				69.2	62.8	
				1,330.8	1,337.2	
Government of Canada loans at 5.25% to 5.63% maturing in 2006 to 2014				0.1	16.4	
Other				0.6	1.2	
				1,331.5	1,354.8	
Less payments due within one year				208.4	13.8	
				1,123.1	1,341.0	

(a) Sinking funds have been established for these issues.

7. LONG-TERM DEBT *Cont'd*

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co

millions of dollars	2005	2004
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $21.2; 2004 - U.S. $32.0)	24.8	38.3
7.875% Series B due December 15, 2007	2.2	3.2
General Mortgage Bonds		
7.500% due December 15, 2010	38.9	39.7
	65.9	81.2
Less payments due within one year	14.2	14.6
	51.7	66.6

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however, fixed sinking fund payments are estimated to be as follows:

millions of dollars	2006	2007	2008	2009	2010
	14.2	14.2	0.7	0.7	35.9

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999, places additional restrictions on dividends, based on cash flow.

8. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, bears interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2004 - $0.4) is included in accounts payable and accrued liabilities.

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of $4.1 million (2004 - $4.1 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. The most recent actuarial valuation was performed as at December 31, 2004.

millions of dollars	2005	2004
Accrued benefit obligation		
Balance at beginning of year	46.4	39.5
Current service cost	1.6	1.6
Interest cost	3.0	2.8
Actuarial loss	-	4.2
Benefits paid	(2.0)	(1.7)
Balance at end of year	49.0	46.4
Plan deficit	49.0	46.4
Unamortized actuarial loss	(10.2)	(10.7)
Unamortized past-service cost	(0.3)	(0.3)
Accrued benefit liability at end of year	38.5	35.4

millions of dollars	2005	2004
Current service cost	1.6	1.6
Interest cost	3.0	2.8
Actuarial losses	-	4.2
	4.6	8.6
Adjustments		
Difference between actual actuarial loss and amount recognized	0.5	(3.4)
Benefit expense	5.1	5.2

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2005	2004
Discount rate	6.3%	6.3%
Rate of compensation increase	3.5%	3.5%
Assumed healthcare trend rates:		
	2005	2004
Initial healthcare expense trend rate	12.0%	12.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	2010	2010

10. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2005 and 2004, are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
millions of dollars	**2005**		2004	
Financial Assets				
Sinking funds	**85.8**	**102.0**	72.6	81.0
Long-term receivable including amount due in one year	**107.4**	**139.2**	139.2	139.0
Financial Liabilities				
Long-term debt including amount due in one year	**1,397.4**	**1,783.8**	1,436.0	1,751.0
Long-term payable including amount due in one year	**1.1**	**1.1**	1.5	1.6

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2005, of the total accounts receivable balance outstanding approximately 52.4% (2004 - 51.8%) is due from a regulated utility, and 19.2% (2004 - 19.8%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2033. Hydro debentures, which Management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2004 - 4.77% to 9.86%).

11. INTEREST EXPENSE

millions of dollars	**2005**	2004	
Gross interest			
Long-term debt	**108.3**	110.4	
Promissory notes	**4.5**	4.1	
	112.8	114.5	
Amortization of debt discount and financing expenses	**1.0**	1.1	
Provision for foreign exchange losses	**2.3**	2.2	
Foreign exchange gain	**(0.1)**	(0.2)	
	116.0	117.6	
Less			
Recovered from Hydro-Québec	**1.5**	2.2	(a)
Interest capitalized during construction	**4.3**	3.6	
Interest earned	**18.7**	22.7	
Net interest expense	**91.5**	89.1	
Debt guarantee fee	**14.4**	14.6	
Net interest and guarantee fee	**105.9**	103.7	

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

CF(L)Co can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

12. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out in 2006, 2010 and every five years thereafter. These recommendations are currently under review by the regulatory agencies.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately $1.3 million (2004 - $8.5 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $22.2 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $13.9 million at December 31, 2005 (2004 - $7.4 million).

13. SUBSEQUENT EVENTS

In January 2006, Hydro applied to Hydro-Québec TransÉnergie for transmission service to transmit Lower Churchill power from the Labrador/Québec border into Québec and other markets. Hydro-Québec will conduct an initial assessment and detailed engineering studies to determine feasibility. Hydro's deposit of $17.2 million is refundable if the application is rejected or withdrawn prior to entering into a service agreement.

14. COMPARATIVE FIGURES

Certain of the 2004 comparative figures have been reclassified to conform with the 2005 financial statement presentation.

Financial Statistics

Years ended December 31 (millions of dollars)	**2005**	2004	2003	2002	2001[1]
OPERATING RESULTS					
Revenue					
Energy sales	**453.9**	439.8	407.8	399.6	374.8
Rentals and royalties	**0.3**	0.3	0.3	0.3	0.3
Recovery of costs in RSP	**56.5**	34.2	16.7	14.0	11.2
Guaranteed winter availability	**16.4**	14.6	11.9	9.5	7.5
Other	**5.4**	4.6	4.8	4.2	3.3
	532.5	493.5	441.5	427.6	397.1
Expenses					
Operations and administration	**130.8**	123.4	125.8	125.8	119.1
Amortization of RSP costs	**56.5**	34.2	16.7	14.0	11.2
Fuels and power purchased	**120.4**	119.2	110.7	89.0	65.8
Depreciation	**47.0**	45.8	45.0	43.0	44.5
Interest	**105.9**	103.7	99.3	97.8	102.5
	460.6	426.3	397.5	369.6	343.1
Income before unusual items	**71.9**	67.2	44.0	58.0	54.0
Write down of capital assets	**-**	-	130.9	-	-
Net income (loss) before non-controlling interest	**71.9**	67.2	(86.9)	58.0	54.0
Non-controlling interest	**-**	-	(12.3)	-	-
Net income (loss)	**71.9**	67.2	(74.6)	58.0	54.0
Contributions to net income (loss)					
Hydro Corporate	**50.5**	47.6	18.1	40.9	40.4
CF(L)Co	**21.4**	19.6	16.3	17.1	13.6
GIPCo	**-**	-	(96.3)	-	-
LCDC	**-**	-	(12.7)	-	-
FINANCIAL POSITION					
Total current assets	**181.8**	171.6	143.1	140.2	141.2
Total current liabilities	**470.0**	273.6	271.1	326.4	360.6
Net working capital	**(288.2)**	(102.0)	(128.0)	(186.2)	(219.4)
Capital assets	**2,632.6**	2,600.8	2,573.5	2,650.4	2,545.6
Accumulated depreciation	**851.0**	816.3	780.5	745.7	707.6
Capital assets, net	**1,781.6**	1,784.5	1,793.0	1,904.7	1,838.0
Sinking funds	**85.8**	72.6	62.2	44.6	38.2
Other assets	**154.9**	187.9	225.1	225.7	202.3
Long-term debt	**1,174.8**	1,407.6	1,447.8	1,354.9	1,156.7
Other liabilities	**52.3**	44.5	34.5	44.4	43.3
Shareholder's equity	**507.0**	490.9	477.9	593.6	663.6
STAFFING LEVELS AT YEAR END					
Full Time Equivalents (FTE)	**1,144**	1,149	1,190	1,220	1,246

(1) Restated to reflect Churchill Falls' adoption of new recommendations of Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses.

Operating Statistics

Years ended December 31	**2005**	2004	2003	2002	2001
INSTALLED GENERATING CAPACITY (rated MW)					
CF(L)Co	**5,428**	5,428	5,428	5,428	5,428
Twin Falls	**225**	225	225	225	225
Hydro					
Hydraulic	**939**	939	939	899	899
Thermal	**640**	640	640	640	640
Diesel	**56**	57	57	57	58
Total	**7,288**	7,289	7,289	7,249	7,250
ELECTRIC ENERGY GENERATED, NET (GWh)					
CF(L)Co	**33,563**	32,800	33,457	35,516	32,910
Hydro					
Hydraulic	**4,770**	4,726	4,321	3,986	3,959
Thermal	**1,320**	1,641	1,950	2,380	2,095
Diesel	**43**	46	45	48	46
Total	**39,696**	39,213	39,773	41,930	39,010
ELECTRIC ENERGY SALES (GWh)					
CF(L)Co					
Export	**28,748**	28,330	28,647	30,782	28,159
Hydro					
Utility	**4,664**	4,709	4,642	4,589	4,423
Rural	**859**	886	878	894	832
Industrial	**1,685**	1,842	1,711	1,675	1,528
Export	**1,422**	1,456	1,439	1,481	1,558
TwinCo Industrial	**1,803**	1,468	1,785	1,669	1,724
Total	**39,181**	38,691	39,102	41,091	38,220
AVERAGE RATE (cents per kWh)					
CF(L)Co					
Export	**0.25**	0.26	0.25	0.25	0.27
Hydro					
Utility	**5.25**	4.99	4.79	4.60	4.50
Rural	**6.13**	5.87	5.68	5.59	5.60
Industrial	**3.43**	3.24	3.14	3.08	3.14
Export	**3.48**	3.41	2.27	2.27	2.22
TRANSMISSION LINES (km)					
CF(L)Co					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,608**	1,608	1,608	1,533	1,534
138 kV	**1,500**	1,500	1,500	1,533	1,533
69 kV	**634**	589	589	586	587
Total	**4,781**	4,736	4,736	4,691	4,693
PEAK DEMAND (MW)					
CF(L)Co System	**5,608**	5,645	5,615	5,587	5,637
Hydro System	**1,361**	1,405	1,402	1,403	1,262

We are focused on being

progressive. poised. a valued corporate citizen

in Newfoundland and Labrador.

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Derrick Sturge(1)
Vice-President Finance and CFO

Jim Keating
Vice-President Business Development

Andy MacNeill
General Manager Churchill Falls

Jim Haynes
Vice-President Regulated Operations

Gilbert Bennett
Vice-President Lower Churchill

(1) Appointed March 20, 2006

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Vice-President
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Peter Hickman
Assistant Corporate Secretary

THESE ARE SOME OF THE CHARITABLE ORGANIZATIONS HYDRO SUPPORTED IN 2005.

Arthritis Society – Newfoundland & Labrador, Big Brothers/Big Sisters, Boys and Girls Club of Newfoundland and Labrador, Canadian Breast Cancer Foundation, Canadian Diabetes Association – Newfoundland & Labrador, Canadian Liver Foundation – Newfoundland & Labrador, Canadian Mental Health Association – Newfoundland & Labrador, Canadian National Institute for the Blind, Junior Achievement, Canadian Paraplegic Association, Canadian Red Cross – Newfoundland & Labrador Region, Captain William Jackman Memorial Hospital, Central Newfoundland Regional Health Centre, Cerebral Palsy Association of Newfoundland and Labrador, Choices for Youth, Community Food Sharing Association, Conservation Corps Newfoundland and Labrador, Dr. H. Bliss Murphy Cancer Care Centre, East Coast Trail Association, Easter Seals Newfoundland & Labrador, Epilepsy Newfoundland & Labrador, Festival 500, Grenfell Regional Health Services, Healing Hands Campaign (South and Central Health Foundation), Health Labrador Corporation, Health Care Foundation, IEEE Newfoundland and Labrador Section, James Paton Memorial Hospital, Janeway Children's Hospital Foundation, Kids Eat Smart, Labrador Heritage Society, Learning Disabilities Association of Newfoundland & Labrador, MUN Faculty of Business Administration, Nature Conservancy Canada, Newfoundland and Labrador Crime Stoppers, Newfoundland and Labrador Library Association, Newfoundland and Labrador Snowmobile Federation, Newfoundland Symphony Orchestra, Newfoundland Symphony Youth Choir, REAL Program, Scouts Canada, Seniors Resource Centre, Sir Thomas Roddick Hospital Foundation, Stella Burry Community Centre, Vera Perlin Charitable Foundation Inc., Western Memorial Regional Hospital Foundation, YM/YWCA

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Maurice McClure
General Manager
Financial Planning
and Cost Management
Iron Ore Company of Canada

Matthew Simpson
Manager, Energy
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Engineering Services
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Jim Haynes
Vice-President
Regulated Operations
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Hydro

LOWER CHURCHILL DEVELOPMENT CORPORATION LIMITED

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Chief Executive Officer
Persona Inc.

David Burpee
Director,
Electrical Utilities Division
Electricity Branch, Energy Sector
Natural Resources Canada

Jim Haynes
Vice-President
Regulated Operations
Newfoundland and Labrador
Hydro

HYDROWISE ENERGY CONSERVATION PROGRAM

In 2003, Newfoundland and Labrador Hydro launched its conservation education program – Hydrowise. The program is a multi-year education initiative aimed at provoking interest in energy conservation and assisting residents of this province to better manage their energy costs. This initiative reflects our continued commitment to our customers and all residents in conserving energy and ultimately managing our resources.

Hydrowise will continue to educate and inform customers over time in a continuous and consistent manner. Conservation is not a one-time effort; it is something that has to be integrated into everyones' way of thinking. We are committed to providing customers with the information they need to make wise decisions and take action to lower their energy costs.

Hydrowise School Program

In 2005, Hydro went back to school. The company launched the Hydrowise School Pilot Program aimed at educating Grade 2 and 3 students about conservation. By talking to children we are also educating their families on the practices that can reduce their energy usage.

This fun and interactive program was piloted at Bay d'Espoir Academy in the fall. Integrated into the class curriculum, teachers were given a kit of resources to lead their class through a series of Secret Missions designed to take them from Agents in Training to Hydrowise Special Agents. Feedback from the pilot was overwhelmingly positive and plans are underway to expand the program to other schools in the province.

Energy Conservation Tips

Take it away. Keep baseboard heaters clean and free from obstruction to allow air to circulate.

Open and close. Close drapes at night for insulation and open them during the day to let the sun in.

Turn it down. Turn back thermostats to 16ºC at night and when no one's home for 8 hours. Save 2% for every degree reduced.

Change your boiling point. Use an electric kettle instead of a stove kettle. It's faster and more efficient.

Turn it off. Turn off lights, computers and appliances, even if you're gone only a short time.

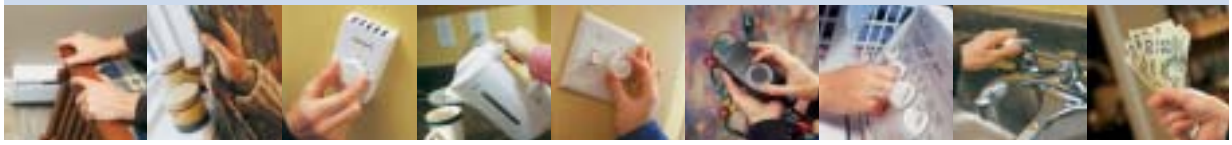
Take time out. Use timers on outside Christmas lights so you don't forget and leave them on.

Top it up. Wash and dry in full loads and use cold water for most laundry. Next to your space heaters, your hot water tank is the largest user of electricity in your home.

Stop it up. Fix leaky hot water faucets. One drop per second is equal to 16 hot baths a month!

Caulk it. Use caulking and/or weather-stripping around windows, doors and other openings in the exterior walls.

Cool it down. Check the thermostat settings on your hot water tank—140ºF with a dishwasher and 130ºF without.



2005 Installed Generating Capacity

Megawatts (MW)

THE HYDRO GROUP

CF(L)Co

LABRADOR

Interconnected

Hydraulic	
Churchill Falls	5,428

HYDRO

LABRADOR

Interconnected

Thermal (Diesel)	
Happy Valley-Goose Bay	11.7
Mud Lake	0.1
Thermal (Gas Turbine)	
Happy Valley-Goose Bay	27.0

Rural Isolated

Thermal (Diesel)	
15 Sites	22.5
Black Tickle	
Cartwright	
Charlottetown	
Hopedale	
L'Anse-au-Loup	
Makkovik	
Mary's Harbour	
Nain	
Norman Bay	
Paradise River	
Port Hope Simpson	
Postville	
Rigolet	
St. Lewis	
Williams Harbour	

ISLAND

Interconnected

Hydraulic	
Bay d' Espoir	604
Cat Arm	127
Upper Salmon	84
Granite Canal	40
Hinds Lake	75
Paradise River	8
Snooks Arm/ Venams Bight	1
Roddickton	0.4
Thermal (Oil)	
Holyrood	490
Thermal (Gas Turbine)	
Hardwoods	54
Stephenville	54
Holyrood	15
Thermal (Diesel)	
Hawke's Bay	5
St. Anthony	9.7

Rural Isolated

Thermal (Diesel)	
7 Sites	7.4
François	
Grey River	
Little Bay Islands	
McCallum	
Ramea	
Rencontre East	
St. Brendan's	

LEGEND

- Generating Station
- Terminal Station
- Diesel Plant

Transmission Lines

- 735-kV
- 230-kV
- 138-kV
- 69-kV
- Low Voltage
- Customer-Owned

2005 GROSS ISLAND INTERCONNECTED ENERGY SUPPLY

Gigawatt hours (GWh)

Hydraulic Generation	
Bay D' Espoir	2,847
Cat Arm	684
Upper Salmon	590
Hinds Lake	376
Granite Canal	243
Paradise River	39
Mini Hydro	7
	4,786
Percentage of Total Energy Supply	72%

Power Purchases	423
Percentage of Total Energy Supply	6%
Thermal Generation	
Holyrood	1,414
Gas Turbine and Diesel	2
	1,416
Percentage of Total Energy Supply	21%

POTENTIAL

HYDRO
THE POWER OF COMMITMENT

www.nlh.nl.ca

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