Credit Opinion: Newfoundland Power Inc.

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Canada

Ratings

Category	Moody's Rating
Outlook	Stable
First Mortgage Bonds -Dom Curr	Baa1

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Key Indicators

Newfoundland Power Inc.

	2006	2005	2004	2003
(CFO Pre-W/C + Interest) / Interest Expense [1]	2.7x	2.9x	3.0x	2.9x
(CFO Pre-W/C) / Debt	14.1%	15.7%	16.0%	15.6%
(CFO Pre-W/C - Dividends) / Debt	9.8%	10.1%	12.5%	13.1%
(CFO Pre-W/C - Dividends) / Capex	69.0%	74.4%	81.8%	77.4%
Debt / Book Capitalization [2]	55.8%	63.2%	55.5%	56.0%
EBITA Margin %	17.7%	19.6%	19.6%	19.5%

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items [2] In 2005, NPI's defined benefit plan underfunding resulted in Moody's standard balance sheet adjustments which reduced its capitalization by approximately $58 million, leading to an increase in the Debt/ Book Capitalization ratio. In the absence of any adjustments, Debt/Book Capitalizaton would have been 54.2%

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Newfoundland Power Inc (NPI) is a vertically integrated electric utility which operates under cost of service regulation as administered by the Board of Commissioners of Public Utilities of Newfoundland and Labrador (PUB) under the Public Utilities Act (the Act). It is a wholly-owned subsidiary of Fortis Inc. (not rated), an electric utility holding company.

NPI owns and maintains over 10,000 kilometers of transmission and distribution lines and delivers electricity to approximately 229,000 commercial and residential customers on the island portion of the Province of Newfoundland and Labrador. Generation forms a relatively small portion of NPI's revenues and assets consequently NPI purchases approximately 90% of its power requirements from the provincially-owned Newfoundland & Labrador Hydro (Hydro). NPI generates the balance of its power requirements via 23 hydro plants, three diesel plants and three gas turbine facilities, which in aggregate have an installed capacity of roughly 135.6MW. NPI's power purchases from Hydro are regulated by the PUB, and costs of purchased power are passed through to ratepayers.

Recent Developments

Since Moody's initial rating of NPI in 2005, NPI's cash flow credit metrics have weakened somewhat. For instance (CFO Pre-W/C)/Debt has declined from 16.0% in 2004 to 14.1% in 2006. Similarly, CFO Pre-W/C Interest Coverage has declined from 3.0x in 2004 to 2.7x in 2006. Moody's believes that this deterioration reflects the fact that NPI has not had a rate increase since 2003 when rates were increased following the company's 2002 general rate application (GRA). It also reflects the impact of declining bond yields which have resulted in lower allowed returns on rate base and ROE by operation of the annual automatic adjustment formula utilized by the PUB to adjust rates between GRAs. As a result of the foregoing, NPI has experienced declining FFO while debt levels and interest expense have increased resulting in the weakening of the company's cash flow credit metrics. The company expects to file a GRA in 2007, with any changes to rates to take effect in 2008.

Rating Rationale

Pursuant to Moody's Global Regulated Electric Utilities Rating Methodology, NPI is considered to be a low risk utility given that its operations are wholly regulated and that it operates in Canada, a jurisdiction that is generally viewed as having one of the more supportive regulatory environments for utilities on a global basis. NPI's ratios are generally consistent with, albeit somewhat weaker than, those of other Baa1 companies that are predominantly engaged in transmission and distribution such as Atlantic City Electric and FortisAlberta (a sister company to NPI). Atlantic City Electric and FortisAlberta have reported (CFO Pre-W/C)/Debt in the 16-19% range versus NPI's sub-15% level. Similarly, Atlantic City Electric and FortisAlberta have reported CFO Pre-W/C Interest Coverage in the 3.5-4.5x range versus NPI's sub 3x range.

The Baa1 rating assigned to the First Mortgage Bonds (FMB) is reflective of the FMB's first mortgage security over NPI's property, plant and equipment. All assets are pledged as security and all current and future FMB issuances must be in support of prudently-incurred costs and pre-approved by the PUB.

The rating also reflects NPI's low business risk as a cost of service-regulated monopoly utility whose operations are predominantly transmission and distribution which Moody's generally believes to be the lowest risk segments for electric utilities. The fact that NPI's service territory is geographically isolated, and therefore largely removed from competition, and exhibits relatively low, predictable growth contributes to Moody's view of NPI as a low risk utilitiy. Moody's considers NPI's regulatory environment to be relatively supportive and notes that the rate making construct includes measures that largely eliminate NPI's exposure to commodity price and volume risk. Furthermore, Moody's expects that the Newfoundland electricity market is unlikely to undergo significant restructuring in the foreseeable future.

The rating considers NPI's status as a subsidiary of its parent, Fortis Inc., a Canadian utility holding company. While NPI is one of a number of utility operating companies owned by Fortis, Moody's considers NPI to be operationally and financially independent from Fortis. While the parent could seek to increase dividend payments from NPI to support the operations of the holding company or other utility operating companies, the level of dividends has not historically been stressful for NPI. This is consistent with Fortis' philosophy of allowing its utility subsidiaries to operate on a stand-alone basis. Moody's expects that NPI will continue to implement a dividend policy which will maintain its capital structure at or near the 45% maximum equity permitted by the PUB. Furthermore, NPI's financial independence is supported by features of its credit agreements and of the Act. NPI's bank credit agreement contains covenants which prohibit affiliate loans and guarantees and place meaningful restrictions on all other affiliate transactions. The Act prohibits the provision of inter-corporate loans which would disadvantage the interest of ratepayers or which would provide little benefit to ratepayers or NPI.

Moody's views NPI's liquidity facilities to be supportive of its rating. In January 2006, NPI replaced its $100 million, 364-day syndicated committed revolving credit facility with a $100 million, three-year syndicated committed revolving facility. The facility can be extended at the Lenders' discretion. While the facility does not have the term-out provision that its previous 364-day facility contained, Moody's expects that NPI will seek to extend the facility prior to its second anniversary in order to ensure that the company never has less than one year's committed liquidity available to it. Moody's notes that availability under NPI's syndicated credit facility could be constrained in adverse circumstances due to the existence of a Material Adverse Change (MAC) clause. However, the MAC clause is tempered by a carve-out for adverse weather conditions, which is one of the most likely events that could negatively affect the company's performance. The credit facility will be utilized in part to fund NPI's capital expenditure program of approximately $55-$65 million in the coming years. As of December 31, 2006, approximately $34.4 million was drawn against the committed credit facility.

NPI expects to periodically issue additional FMBs to refund borrowings under the syndicated credit facility. NPI has a manageable maturity profile, with the next significant maturity of approximately $35.7 million occurring later in 2007 but no other maturities (with the exception of annual 1% sinking fund installments) until 2014. Moody's expect that NPI will refinance the $35.7 million FMB maturity in 2007 with the issuance of additional FMBs. Consistent with most electric utilities, it is expected that NPI will continue to be modestly free cash flow negative after capital spending and dividends for the foreseeable future, assuming moderate but steady cash flow, relatively constant capital expenditures, and no large changes to dividend policy.

Rating Outlook

The rating outlook is stable based on the expectation that NPI's 2007 GRA will result in a strengthening of the company's cash flow credit metrics beginning in 2008. If it appears that in 2008 NPI's (CFO Pre-W/C)/Debt will be materially below 15% or that its CFO Pre-W/C Interest Coverage will be materially less than 3.0x, the company's outlook and rating could be negatively impacted.

What Could Change the Rating - Up

The rating could be positively impacted if NPI could demonstrate expectations for a sustained improvement in financial ratios, such as CFO Pre-W/C Interest Coverage above 4.0x and (CFO Pre-W/C)/Debt above 20%. This level of improvement in NPI's credit metrics could result from a rate increase, coupled with either an increase in equity in the capital structure or the equity risk premium utilized by the regulator to automatically adjust the allowed rate of return on rate base between full cost of capital hearings. Moody's considers an upward revision in NPI's rating to be unlikely in the near term.

What Could Change the Rating - Down

NPI's rating could be negatively impacted if by 2008 CFO Pre-W/C Interest Coverage has not met or exceeded 3.0x and (CFO Pre-W/C)/Debt has not met or exceeded 15%.

Rating Factors

Newfoundland Power Inc.

Select Key Ratios for Global Regulated Electric Utilities

Rating	Aa	Aa	A	A	Baa	Baa	Ba	Ba
Level of Business Risk	**Medium**	**Low**	**Medium**	**Low**	**Medium**	**Low**	**Medium**	**Low**
CFO pre-W/C to Interest (x) [1]	>6	>5	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0	<2.5	<2
CFO pre-W/C to Debt (%) [1]	>30	>22	22-30	12-22	13-25	5-13	<13	<5
CFO pre-W/C - Dividends to Debt (%) [1]	>25	>20	13-25	9-20	8-20	3-10	<10	<3
Total Debt to Book Capitalization (%)	<40	<50	40-60	50-70	50-70	60-75	>60	>70

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