Q. NP (page 1-7) indicates that the provincial economy is "*struggling*". Please compare the forecast state of the provincial economy over the two test years based on GDP growth rate, unemployment rate, inflation, provincial long-term debt yields (or borrowing cost), and electricity costs for a typical residential user compared to 1991 when the Board approved a common equity ratio in a range of 40-45%. If this is not practical, please file any extracts regarding the provincial economy entered into evidence at the time of that Board decision.

A. The following attachments provide extracts regarding the provincial economy entered into evidence at the time of the Board's decision in 1991.

Attachment A: Dr. Roger A. Morin

Attachment B: Mr. Paul Hamilton

Attachment C: Request for Information NLH-42, Credit Rating Agency Reports

Dr. Roger A. Morin

premises, and its own set of simplifications of reality. Each method proceeds from different fundamentaJ premises which cannot be validated empirically. Investors do not necessarily subscribe to any one method, nor does the stock price reflect the application of any one single method by the price-setting investor. -Absent any hard evidence as to which method outdoes the other, all relevant evidence should be used and weighted equally, in order to minimize judgmental error, measurement error, and conceptual infirmities.

11.OPERATING ENVIRONMENT

INTEREST RATES AND THE ECONOMY

Q. **Please discuss the** current Interest rate environment In which **NLP operates.**

A. Following a seven-year expansion, both the U.S. and Canadian economies are experiencing a severe recession. The Canadian economy grew at a mere 0.9% rate in 1990, compared to a growth rate of 4.3% and 3.1% in 1988 and 1989, respectively. As of June 1991, both the U.S. and Canada continue to experience rising unemployment and slower spending. Recently released indicators (retail trade, real gross domestic product, output) confirm that the economy is still in the midst of a recession, with some modest signs of impending recovery.

Estimates of real economic growth for 1991 and 1992 indicate a further contraction of 0.3% for 1991 followed by a modest rate of growth of 3.6% in 1992. The implementation of the Goods and Services Tax (Gsn in early 1991 is contributing to continuing economic stagnation for the remainder of 1991. Hopefully, the economy is poised for a recovery in early 1992, and possibly by autumn 1991. Increased exports, large energy investments, a rebound in the housing and automotive markets is already sowing seeds of recovery.

With respect to inflation, the Consumer Price Index (CPI) was 4.7% in 1990, is forecast to increase to 5.8% in 1991 and to decrease to 3.8% in 1992. The jump in oil prices at the end of 1990 and the implementation of the GST in January 1991 will put pressure on inflation in 1991.

Over the past two years, long-term bond markets have continued to exhibit volatility. In the first half of 1989, yields oscillated in a narrow range around the 10% level, before falling to the 9.5% level for the remainder of 1989. For the first half of 1990, the yields on long-term Canada bonds increased markedly and reached a peak of above 11.00% in May 1990. They hovered near that level until the fall of 1990, and have decreased steadily to the current level of about 10.0% as of June 1991, in response to the weak economy and the central bank's accommodating monetary stance. The yield spread for NLP debentures over long Canada bonds is of the order of 115-125 basis points.

Long term interest rates are not expected to decline much further over the next few months or over the next year, and may even increase as the first signs of economic recovery are manifest. The consensus investor expectation is that long-term rates will on balance remain close to a current level of 10.0%, possibly increasing slightly as the recovery takes shape. Two observations tend to support this view. First, market forecasts of rates on U.S. Treasury bonds in the form of interest rate futures contracts yields are available, and can be employed as proxies for the expected spot yields on long-term government bonds. The current structure of yields ext�nding out to March 1992 is virtually constant, as evidenced by the constant structure of futures contract prices (see Financial Post, 6/10/91).

Second, consensus economic forecasts indicate that long-term interest rates will at best remain unchanged over the remainder of 1991 and may increase slightly in 1992. Forecasts contained in the Conference Board's "Canadian Outlook", and the Consensus Forecast suggest unchanging to slightly rising long-term rates. Thus, the evidence from both the futures markets and from consensus market forecasts is consistent with a steady to slightly rising trajectory in long-term capital costs generally over the forecast period.

Already, the first signs of impending recovery from th� recession are emerging. The recent stock market rally was the first sign, and the rebounding of the narrow money supply (M1) was the second. In short, the Canadian economy is expected to have bottomed out and to start growing .again by early 1992 and possibly by fall 1991. Interest rates are expected to remain at the current levels or possibly increase mildly as the economic recovery begins.

RISK ENVIRONMENT

Q. Please describe NLP's current risk environment.

A. It is customary to disaggregate a company's total risk into two broad components: business risk and financial risk.

TOTAL RISK = BUSINESS RISK + FINANCIAL RISK

Business risk refers to the relative variability of operating profits induced by the external forces of supply (supply risk) and demand for the firms' products (demand risk), by the relative employment of fixed assets (operating leverage), by the extent of diversification of output, and by the quality of regulation (regulatory risk):

BUSINESS RISK= DEMAND RISK+ SUPPLY RISK+ REGULATORY RISK

A further distinction is frequently made as between short-term and long-term business risks.

Financial risk refers to the additional variability of earnings induced by the employment of fixed cost financing, that is, debt and preferred stock capitat

Since the last rate decision in 1989, NLP's short-term business risks have increased slightly due mainly to the economic recession, while financial risks and regulatory risks have remained largely unchanged. Relative to other Canadian utilities, NLP possesses average risks. The section below addresses the various dimensions of business, regulatory, and financial risks.

BUSINESS RISK

Q. Please elaborate on NLP's investment risks.

A. Competition in the energy industry in Newfoundland is increasing. On the one hand, customers have alternative means of filling their energy (heating) needs, namely oil. On the other hand, supplies of power from Newfoundland Hydro have become riskier due to price and regulatory uncertainty. It is becoming more difficult to forecast demand, market behavior, financing requirements, earnings, and cash flows.

In the short-run, investors are uncertain as to the final impact of the economic recession generally and the serious deterioration in Newfoundland's natural resource based economy particularly on the demand for NLP's product. The company's vulnerability is enhanced in the present recession, and is compounded by volatile fuel prices. In the longer-run, competition from fossil fuels will intensify over the next several years. The Hibernia development has not had any substantial impact on the Newfoundland economy.

Another crucial dimension of business risk is power supply risks. and they have also increased. Pricing risk refers to changes in the price of purchased power. Given the recent provincial government action of abolishing the subsidies to Newfoundland Hydro. the shortfall in revenues has to be met by rising prices charged NLP for purchased power. This reduces the competitiveness of electricity versus oil. The final impact on NLP's revenues is uncertain.

REGULATORY AND FINANCIAL RISK

With respect to regulatory risk, the Board's last rate order has been perceived by investors as fair and representative of the quality of regulation which has usually characterized this board's decisions in the past. NLP's regulatory risk is below average relative to other Canadian utilities.

With respect to financial risks, while NLP's coverage ratios and debt ratios have deteriorated slightly in recent years, but relative to other Canadian utilities, NLP's financial risks are unchanged. In other words, NLP's financial risks have risen in absolute terms, but have not changed relative to other utilities.

In short, NLP's short-term business risks have increased since the last rate decision due mainly to the economic recession, while financial risks and regulatory risks have remained largely unchanged. Relative to other Canadian utilities, NLP possesses average risks.

Mr. Paul Hamilton

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

DIRECT TESTIMONY OF PAUL HAMILTON

a. Please state your name, address, and occupation.

A. My name is Paul Hamilton. I live in St. John's and I am employed as Manager, Rates & Forecasts Department with NewfQundland Light & Power Co. Limited ("the Company").

a. What la the nature of your testimony?

A. In my testimony, I will describe the Customer and Energy Sales Forecasts on which this Application is based. I will explain the relationship of the Company's long term rate design objectives to sound rate design criteria and to the Company's commitment for a least cost planning process, particularly the role rates play In supporting Demand Side Management programs. I will then outline the proposed rates and discuss the Impacts they_ will have on our various customer classes. Finally, I will describe modifications that are proposed to the Rules and Regulations.

Customer & Energy Sales Forecasts

a. How did the 1990 energy $Bies results compare to the forecast presented at 1he 1989 hear1ng?

A. The 1990 data regarding customers. energy sales and average use is shown in AFR-1. As this data is not adjusted for weather conditions, the changes In energy sales and average use from year to year do not represent the real growth. PRH-I, Page 1 shows 1990 data after adjustment for weather conditions compared to the forecast. Additional information such as the penetration of electric heat and conversions to electric heat by Domestic customers are also shown.

In 1990, weather adjusted sales were 4,174 Gwh, Which is 44 Gwh more than the forecast of 4,130 GWh presented at the 1989 hearing. This gain was attributable to a $Ignificant increase In the Domestic average use, particularly In the Domestic All-Electric category. The Domestic All-Electric average use was forecast to Increase to 20,245 kWh/year in 1990. As shown on Page 1 of PRH-1, the Domestic All-Electric average use actually Increased to 20,611 kWh/year in 1990. We believe this difference of 366 kWh/year was mainly due to the fact that electricity costs decreased by 1.5 percent in real tenns in 1990 compared to our assumptions of a 3.5 percent increase. Overall, the Domestic categories accounted for 42 GWh of the 44 GWh variance. The remainder of the variance can be attributed to the General Service category.

Q. Please comment on the customer and Energy Sales Forecast♦ for 1991 and 1992.

A. The forecasts for 1991 and 1992 have been prepared following the same methodology that has been used in the past.

The general assumptions on which ttiey were based are as follows:

1. Gross Domestic Product, in real dollars, will grow by approximately 1 percent in 1991. We recognize this rate is lower than the economic projection published during the first quarter of 1991 forecasting growth of 2.2 percent. However, we understand this projection did not fully account for the impact of the Provincial Budget and associated layoffs, or the problems currently being experienced in the fishing industry. The 1992 growth rate will be 3.6 percent.

2. Personal income In real dollars will grow at 0.5 percent In 1991 and 3.2 percent in 1992.

3. The Consumer Price Index will grow by 5.8 percent In 1991 and 3.7 percent in 1992.

4. Major construction work related to the Hibernia project will begin In early 1992 with production in 1996.

5. The fish quota of 197.000 metric tonnes in 1990 will be reduced by 5,000 metric tonnes in both 1991 and 1992.

6. The annual seasonally adjusted unemployment rate wilt increase to 18 percent in 1991 and decline to 17 percent in 1992.

7. Population in our service territory will grow at approximatel.Y 0.6 percent annually over the forecast period.

8. The retail price of furnace oil will have a 30 to 50 percent cost advantage over electricity during the forecast period.

9. Demand Side Management programs will reduce energy sales by 7 GWh In 1992.

AFR·1 shows the forecasts of customers, energy sales and average use for 1991 and 1992. Page 2 of PRH-1 shows a breakdown of the forecasts of customers and energy sales by rate category along with 1990 weather-adjusted actual data for comparison. The 1991 data reflects five months weather-adjusted actual data plus forecast data for the last seven months.

It can be seen from this tabfe that total energy sales are forecasted to increase by 2.1 percent to 4,262 GWh in 1991 and by 3.8 percent to 4,426 GWh In 1992. The main areas of growth for 1991 and 1992 are expected to be the Domestic All-Electric and General Service All-Electric categories.

The change In average use per customer is the most significant factor affecting Domestic sales growth. The graphs on Page 3 of PRH-1 show the trends in average use for the Domestic Regular and Domestic All-Electric rate categories. The historical data for these curves were adjusted to remove the effects of heating and' cooling loads due to abnormal weather conditions.

The Domestic Regular average use is expected to increase during 1991 and 1992 at a rate typical of the long term trend. This continued growth can be attributed to sev1;tral factors. Contim�ed real growth in personal income and spending power has resulted in a continued increase in the saturation levels of major electric appliances such as electric water heaters. These increased saturation levels have a significant Impact on average use. Also, the percentage of customers using supplementary electric heating and the related electricity use by" each customer have continued to Increase.

During the period from 1981 to 1985, the Domestic All-Electric average use declined as a result of several factors. These included the use of supplementary sources of space heating such as wood, a htgher proportion of new houses built with higher levels of insulation, reduced air Infiltration levels in both existing and n♦ houses, and higher electricity costs associated with the fuel adjustment charge.

From 1985 to 1987, the average use remained falriy constant. Since 1987, the average use per customer has increased significantly as the result of several factors; the elimination ot the fuel adjustment charges, the increased saturation levels of major electric appliances, the decline of electricity prices in real terms while personal incomes have increased, and tt)e significant reduction in the use of supplementary fuels such as wood.

The Domestic All-Electric .average use is expected to decrease in· 1991 and i 992. The primary reason for this decline is the forecast of higher electricity costs for 1991 and 1992. With the increase in electricity costs forecasted to be slgnlflcantly higher than the increase in Household income, consumers will have to spend a greater portion of their Income on electlicity. This will result in increased pressure on consumers to conserve energy and/or use supplementary fuels such as wood.

Tota.l General Service energy sıales are forecasted to grow by 1.1 percent In .1991 and 5.1 percent in 1992. These growth rates are a direct result of the economic activity anticipated over the forecast period. However, as shown on page 2 of PRH-1, energy sales growth varies significantly among the different categories over the forecast period.

Energy sales to General Service customers below 100 kW are relatively consistent as Indicated by 2.9 percent growth in 1991 and 3.5 percent growth in 1.992.

Energy sales to General Service customers over 100 kW are forecast to decline by 2.1 percent in 1991. This decline is the result of the closing of both the St. Lawrence Fluorspar mine and the Baie Verte Mine dry mill operation. The 6.1 percent increase in this C$tegory in 1992 reflects the impact of the construction work related to the Hibernia project at BUii Ann.

Energy sales to the General Service All-Electri.c category are forecast to grow by 2.9 percent in 1991 and 5.1 percent in 1992. This growth is attributable to the combination of two factors. Firstly, economic growth is forecast to be strong in 1992 and will result in an increase in the creation of new businesses. Secondly, a greater percentage of new businesses prefer electric heat. Therefore, most of the new customers and their energy sales will fall into the General Service All-Electric category.

Q. **Haw have actual energy sales compared to your forecasts?**

A. Page 4 of PRH-1 shows the energy sales forecasts and weather-adjusted energy sales for each of the past five years. The forecasted sates figures are from the annual forecasts prepared in the fall of the previous year and were part of the Capital Budget presentations made to the Board in those years. Additionally, the 1986, 1.988, and 1990 forecast figures were the bases for the revenue requirement determinations presented as part of the Company's rate applications in 1986, 1987, and 1989 respectively. Over the past five years, variances from forecast have ranged trom. a high of 3.5 in 1988 to a low of 0.4 percent in 1989 with four of the past five years being 1.1 percent or lower.

Request for Information NLH-42
Credit Rating Agency Reports

Nut-42(i)

a. Provide copies of the latest credit rating agency reports for each of the companies listed in KSW-3.

A. See attached.

NLH-42(b}

a. Provide copies of the credit rating agency reports for the said companies which were issued when the most recent credit rating change occurred for each company.

A. Same as answer 10 NLH-42(a).

Rating A (high) **Newfoundland Light & Power Co. Limited**

Summary Earnings incrused 8.6% for the year.ended 1990, due to the combined effects of a 3.9% rate increase and relali vely strong growth in retail demand for cleclricily (3.4% weather adjus&ed). Return on common equity (adjusted for the timing of an equity issue in December) improved to 14.1 % from 13.9% in 1989, Weakness in the main provincial industries offishing, forestry and mining were balanced by the stability of residential customers, which provide a large portion of company sales. The Hibernia project will help lhe housing industry, but otherwise, it will not be I major user of electricity. Historically, the regulaiory area has been reasonable. Wilh the n 0 thearing expected later in the year, we anticipate 1991 earnings will increase only sligh lly. After a year of record capital inves1ment. 1991 spending is being reduced oonsiderably. The balance sheet should remain reasonable.

Earnings For lhe year ended 1990, earnings after preferred dividends increased 8.6% to $23.8 million. Note that more favowable weather (colder) conditions were neutralized by transfers to the weather normalization accounL Factors leading to higher e.amings were as follows: (l)Openi.ting revenues improved by 10.5% partly as a resultof3 separaic ra1c increases during the year: (a) A general increase of 3.91 % effctive February 1990 was based on recum on common e.quity of 13.95%. (b) In July, rates increased an add.ilional 3.8% to suppon a declining Raic Stabili1.&tion AccounL (c) As e pected, an 8% ri in lhepUJt:base price of power was allowed to now through 10 the cusmmer as a 4.7% raic revision. (Note that 1he latter two rare adjustmenlS had no effect on earnings.) (2) EnC"rgy sales grew 6.1 % (weather adjusted growth of S.4 %) due 10 a largercuslOmer base (2%) and from a general increase in consumption related to higher customer usage and colder than normal weather. In particular, domestic electric heating e,i;perienced above average growth, 811d this area counts for close lO half of Company sales. Sales growth in 1991 is fon:casl at only 2.9% due to: (a) Sales in lhe mining sector will be hurt by the closing of lhe Company's second largest customer. However, it was a low margin customer due to volume discounts and, as a res uh, the shut down is not expected to affecl net earnings.(b) The re<;ession dragging into the second hair of the year wiU continue to hurt the fishery and foreslly industries. (c) Hibernia will not be a major user of electricity, but the anticipated growth in housing construction is favourable. In other areas, operating expense growth was reasonably controlled al 7.5%. The increase in "olher" costs largely rcOed.ed automation expenditures, higher provisions ror doubtful accounts, a larger labour fon:e and costs associated with sleet and electrical storms. Overall, 1991 eamings are projected to rise modestly, butretum on common equity is expected to be slightly below the authorized range of 13.7-14.2%.

Balance Sheet Despite record levels of capital e;,;penditure during the year, the balance sheet remained accplab1e due lo a recent equity issue. Cash flow net of dividends provided 51% of the funding for capital investment ($67 million), while bank debt and a $15 million common stock issue provided the balance. As a resull, the percent debt in the capital structure was stable at 49%, and liquidity ratios remain acceplable. Stronger operating profilS con&ributed to improved coverage ratios, with the fixed charges coverage adequate at 2.2 times. For 1991, capital investment of $50 million has been authorized and financing has recently been arranged through a $40 million bond issue (an additional $10 million will be required later in lhe year), also to be used to reduce shon-icrm debt. Weeitpecl little improvement in the balance sheet in lhe near future as relatively high levels of capital spending will weaken liquidity ratios.

Regulation The regulatory area remains stable since the last filing when the Public Utilities Board ("PUB") authorized a general rate increase of 3.91% effective February 1990. As expect.oo, a rate revision at Newfoundland Hydro was absorbed by the NL&P customer in the form or a 4.7% increase in July. Also at that date, a further 3.8% rate increase took elTt in support of the Rate Sta bilizaLion Account The majority of Newfoundland and Labrador Hydro• s ("Hydro") output (70-80%} is purchased by NL&P, and the recent phasing out orthe provincial subsidy paid to Hydro, will be passed on lo NL&P. (There is a public hearing plannro in the near future regarding this.) For 199 I, the Company has reduced capital spending in order lO maintain a minim um 3 times interest coverage and improve rerum on cquily. The authorized range for return on average common equity remains at 13.7-14.2%, with a common equi1y component aL42-47% or capita.l. Projec&ed 1991 earnings will be slightly below this range and, thus, a ful l rate hearing is expecled laic in 1991 or early 1992.

Power Supply The Company continues to pure hase about 91 % or its req uitemcnts from Hydro, while lhe balance was generated in 22 smaJl hydro-electric plan is owned and opera led by lhe Company. Driven by higher plU'Chasing cos lS, there h been increased focus on non.Hydro sources. In particular, the Company's own generating potent.ial is being examined lo increase capacity or watersheds and improve theemciency of turbines and generatol'3 wherever pracLical. Also the possibility of co•gcneralion is being given serious consideration.

The Company Newfoundland Light and Power is engaged in lhe sale or electricity in tne province of Newfoundland, where it supplies areas containing about 85% of tne province's population. It is largely a retailer of electricily, as 91 % of electricity is purchased in buUc from lhegovemment-owned Newfoundland and Labrador Hydro. The Company is 100%owned by Fortis Inc., which has a widely distributed owne ip.

Debt Rated	First Mortgage Sinking Fund Bonds	A (high)
	General Mongage Sinking Fund Bonds	U A O
	All Series First Preferred Shares	Pfd-2

IDBRSI

Newfoundland Light & Power Co. Ltd.

Balance Sheet

($ m.illiom)	December 31				December 31		
A6Sets	1990	1989	1988	Liabililica & Equiry	1990	1989	)988
Cash & mkl. scc11rilies	0.0	0.0	0.0	Bank borrowings	43.6	12.3	23.3
Accounts re.ccivablc	34.6	32.8	34.8	Account payable	40.9	38.4	34.7
InYenlOrics	7.0	7.1	6.1	Accure.d interest	3.4	3.9	2.3
Prepaid expenses	2.0	2.0	2.7	Dividend& pay•blc	4.5	4.0	3.9
Other CWICnl usets	2.6	2.2	0.0	Other current li•bilitiea	0.0	1.1	3.6
Total curreol assets	46.1	44.0	43.7	L.l,d. due in I year	5.3	13.J	1.8
Deferred charges	S.1	4.4	2.7	Toral current liabilitiea	97.7	73.0	69.6
Net fixed assets	448.8	407.1	372.9	Loa& t.enn debt	157.9	165.0	138.7
				Deferred credits	25.7	22.8	24.7
				Shareboldcn' equiry	218.8	194.7	186.2
	S00.0	455.5	4)9.3		500.0	455.5	419.3

Ratios

	December 31					
	1990	1989	1988	1987	1986	1985
Current ratio	0.47	0.60	0.63	0.71	0.57	0.76
Asset coverage	2.06	2.02	2.14	2.05	2.14	2.13
Total assets/Long term debt	3.17	2.76	3.02	2.77	3.26	2.93
Capital expenditure/Avg. sross fixed assets	0.11	0.10	0.09	0.08	0.07	0.08
Revcnue/Avcrase net fixed assets	0.71	0.71	0.74	0.75	0.77	0.80
total debt D capilAI structure	48.59	49.46	46.&0	48.77	46. 7J	46.96
Cash flow/Long term debl	0.32	0.26	0.30	0.26	0.33	0.30
Capitalized intereat/Pro tsx i.ucome	3.27	3.20	0.98	0.49	0.87	0.83
Depreciation/Gross fixed assets	3.894Ai	3.73'1	3.69%	3.63	3.71%	3.66
Interest coverage-based oo gross interest	2.64	2.49	2.73	2.82	3.08	3.2]
Interest coYeragc-based on net interest	2.85	2.68	2.89	2.84	3.09	3.23
Time, inlerest earned after taxes	2.15	2.10	2.13	2.19	2.2)	2.33
Common diYidcnd payout	56.54%	66.45	60.68◆	59.98	59.54%	51.93%
Profit margin	8.90	7.98◆	8.197'	8.17%	8.28%	8.55
Return on equity (1)	13.05%	12.14%	12.53	12.40%	12.81	13.83
Return on COmIIDD equity (1)	14.05%	13.92	13.66	13.63	IJ.98%	15.20
Common equityffotal equity	IS.86	83.26%	81.92%	79.32%	77.74%	75.994Ai
Cub flow-dividends/Net capilal expenditure	Sl.41 %	48.62 4Ai	57. 734Ai	59.30%	72.31 %	72.30%
Fixed ebugcs covcrase	2.24	2.04	2.18	2.13	2.21	2.19

Income Sratcmeots

($ thousands)	for the year eadcd D cmber 31					
	1990	1989	1988	1987	1986	1985
Sales	305,868	276,823	267,215	250,960	245,427	244,007
Gross operating pro6t	62,269	50,185	52,771	48,507	SJ, 130	50,537
Net income before extr• items	27,209	22,01) J	21,885	20,495	20,324	20,857
Net income after extr• items	26,235	24,448	22,232	20,495	20,324	20,857

Capital Structure

($ millions)	De.ccmbcr 31									
	122Q	%	1989	%	1988	'1	1987		1986	%
horl term debt	48.9	11	25.6	7	25.J	7	19.9	6	29.7	IO
Long term debt	157.9	37	165.0	43	138.7	40	140.6	43	112.3	37
Preferred equity	30.9	7	32.6	8	33.7	IO	34.9	JI	36. I	12
Common equity	187.8	44	162. I	42	152.5	44	133.7	41	125.9	41
	425.S	JOO	385.3	100	350.0	100	]29.2	100	J0,1.0	JOO

(I) 1990 ratios are adjus1cd for the timing or an equity issue in December.

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CBRS
Credit Analyst

Newfoundland Light & Power Co. Ltd.

September 27, 1990 Volume II - UtHi ties - Gas & EJectrial Section

Opinion

'l'hc ruling on NcwfnumJlund l.ighl & Powcr'd ("N1,P") Prcforr·l!d Shams have been u1>criulc1l lo P-2(11ich) from I'-2 'l'hi.s is due to 11n improving preferred dividend cuvcruge r.11b 18.7 lime� m 19891, rcs11lting from a grnclual rl!dcmption of p1·cfcrrcd tiharci; 11nd improved cuming�. NI.P due$ not currently plan to issue any prcftirred e11uity over tlie next lhrcC! ycan but will continue lo rcdl!em existing prefer.red shurcs, resulting in a preforred dividend coverage of over 13.0 times by 1992.

In 1999, dcmand for elcclricily increasod dose lo 7.£ 1·csulling in revenue grnwth uf 4'1-. llowcvcr, car-nings licforc income lilxl!s und tnrnsfers dcclincd 6.8% lo $32.5 mi llion, rcfll.'cling a $I 22 million incru1tsc in opcn1ti11g expense -

In August 1989, the Compuny issued $40 million in Fir:1l MorljJUg-' lhmds, intended lo puy down short-term dchl and to ml:cl capital expenditures. The Company phms t111clher $40 million jSUC in the lotter part of 1990 or early 1991 and an 1:1ddition1tl $15 million in common c4U ity 111 1990.

NI.Pis cut-rcnlly ullowed 1:1l'alc ofrclurn on uvcrage common equity within Lhe rungc of 13.70'1 lo 14.20'1-. Furthermore, the PUC ha!l allowed NLI> to 1iai,s-lhrough u 4.6"1. rale incr(!asc, ta offset a rule increase from Newfoundland ttnd Labntdor llydrn Coq>0r1:1tion ("llydrn").

O\'crall, NLP's financial posi Lion is cons id erect slatble u11d salii;foctory, uhhough ils debt covcragc ratios h1tve ilccli ncd ovcr I he past several yeisrs. Ncvcrlhule!!s, Lhe Cumpany'i, First Morlg1:1ge Honds 11nd General Morlgui,:e Bonds are still considered lo be of goud q1111lly and u c rated A.

j CHJt;UIT HATING	
Finl Mo1·lgugc Honds	A
General Mortgage Bonds	A
Preferred Shares	P-2(Hi1hJ•
•Upgraded	

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Y�ur t:ndcd u�cember 31

ti MillIon. eicepl p�r shue ligllresl

	1989	1988	';1,Chg.
Hcvc:nuc	278.3	268.3	+4
Assels	455.5	419.3	+9
Ctlsh 1"luw	44.2	oll.I	+8
• Nel Euningii	21.4	22.2	+ 10
HOCt-:	13.9%	13.7%	NIA
I>ebUEquily	49.51 L£	47:531>	NIA
Interest Coverage	2.8x	2911	NIA
Preferred div. cov.	9.6x	8.3x	NIA
All Fixed Che.rgcs	23.Jt	2.3.	NIA
C�"ITD	23.2'1,	25.1 I>	NIA

1•1u-;t.11'tlINAHY Uli:SUI.TS
Sis munth� �ud"d June 30

	1990	1989	%Chg.
Itcvcnul!	170.0	159.6	+7'1,
• Ncl Earnings	19.0	17.9	+6'I>

•Uefore ·�ur11. il<'lllil

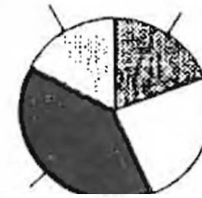
Coq,orul� 1'1·olilei

NLP und ili; prcdcce:isor cu111p1mic1, huve bcUn IJCIII.'rnting 1nd clistributin� electricity 1111 lhU island 1)(Jil ion of the Provinca for over IU0)'C1trs. The present Company wos fuundccl in 1966 lhrou�h the 11111111tga1111:1Lion 11f live dcctric power cumpaoics ticrving lh� province.

The Company Sl!rves approximately I 88,000 customers in over 600 communilies, representing 85·1. o'fthe elt!clrica.l consumers in the province; employs 963 peoplt:; and mdintuin� 9,300 kilomel.rcs or t.ninsmission and distrihulion li ncs. II purchases the hulk of ile encl'gy re,1uircmenli; c9U1.) from llydro, fur cli::1lribuliun ·,nd resale, and ulso ownU and operates 32 emu II 6C!ncreting plants.

'l'hc Compuny's generating c11pacl> cunsisls of; hydro (84,500 k ilowulls); gas turbine 147,000 kilowalls); diesel I 14,300 kilownlls): and .1t:1:1m C30,000 kilowktlts).

SALES **(in millions of** kwh1



Analysis

Outlook

In 1990, earning:; urc µrojcctcd to grow 8'1, lo .ipproxinullcl>· $26.5 million und th<:n gradually incrcitse to upproximittcly $30 million by 1992. 'I'ht! Comp1rny di\'idend payout rulio will be 55-fi0◆ of curning1t.

Cupilul cxptmtlitm·cs ttrc cstimu.lc,l lo incrct1se I6'It lo $64.7 million in 1990 t1nd Lula) atpproximalely $350 million over thli 1990-199-l period. l•'unds will be htrgely allncatled lo improvements 11nd cxl1:11i.ions to the ·1nrnsmission u.nd distribution systems in or,h!r lo meet increasing dcma11d of its cuslomcn1.

Strengths

NLP i◆ the lllljor rclu ilcr of clcclrica l cncr◆y in the l'rnvince 1>roviding clcctricul encrt{y to 85'1, of c:uslomcrs. 'l'hrcc-quarters of ttll 1tc1lS arc to rl!i;idcnlit1l uud small gcncrul service customers • which reduces Lhc Cm◆1p.u◆y s exposure to cyclical un◆ cconclliili◆ dow11Lurl_lS. l'uithc1more, Lhc Compuny cunllnucs Lo 1ncteuse 1ls shure of the residential spucc hculing 1m1rklll, cupluring O\'er 70◆ of new homus. Currently, over 50'1. uf all rc:s1dcnt1al homes in Newfoundlund are clcctricully hc.ntcd.

In 1989, sulcs grnw ♭y 6.8% lo 3,993 million lr.wh parl lv due lo o 2 5% iocrcusc in itt1 cusl.IJ mur buse l◆ 188,575. In addition, rising dcm1md for clccldcity hus 11lso rusulted f'om tlw increased number of eluctrical appli◆nces (dishwashers, VCH's, microwave's, sir cond1t1oners and etc.), found in Newfoundlund homes.

NLJ> maintains cl satisfactory cu pita! structure and 1cbl coverage ratios. The Company has ovl!r lhe pttsl rew _1curs earned i1i. ulluwuble rate of return on common t19u_ity und p◆ys iu1l bctween 55-60% of its earnings in d1v1dends. Earnmgs are forecast.ed lo incrc1uie 8'1. to 1:tpproxim1ttely $26.5 million in 1990 and gradually increes◆ lo lhti $30 million mark by 1992. C11.pitt1l cxpcnchtures arc forecast to average $?Cl million annually over the next five yet1r◆.

Concerns

The Province or Ncwfuundl1tnd has hisloricully been one or the ecunomicully weakest provinces in C1tnt1dt1. Since_ being ttdvcrscly ulTcclC!d hy Lhe 1982 ,·eccssion, Lhe Province ht1s 11111dc some econ◆mic improvements, tiltho,ugh growlh hu:; logged thl! Canudiun ◆veruge. ']'he l◆rovincc's. r.ciwurcc: scclur, cousisling prima.-ily of li_shcry_ IIIIIIIIIH urnl forc.slt·y lmvc enjoyed gout.l yC?urs ◆l11ce 1986. I lnwt•,·cr, the l:urrcnl 11111 luok fur the fort1sl 111dust1·y is 1mc1i1-lai11 due lo Lhc economic sluwduwn and high inlc:,res◆ rate&, while the fi◆hery hl!s been impacted l,y a decline m the .nllowahlc cutch, du◆ to ,;low growlh in fa,;h ◆locks. The mining indu&try Cirun ore 11nd other mincrul cxplorution) rcmttins quite Hlrong in Lubrador.

1'hc uneml)loymcnl rule rcmuins one of Lhe highelil in Canada while personul dispustthlc income i1 one of the lowesl. In addition, the l'rovince'i; taxation rates ere ttmong the hi◆hesl in the country, and Lhe inlroduction oflhe OST will me.kc matters wori;l.

Tt_e economic slowdown mtly ht1ve an impacl on electric sulcH growlh for NI.P, whoso su.les growth is c,cpcclcd to slow from 5% lo 2.2'1. hy 1994. This will impacl NI.P's earnings and diYidond p1tyoul lo ils parent 1-'orlis.

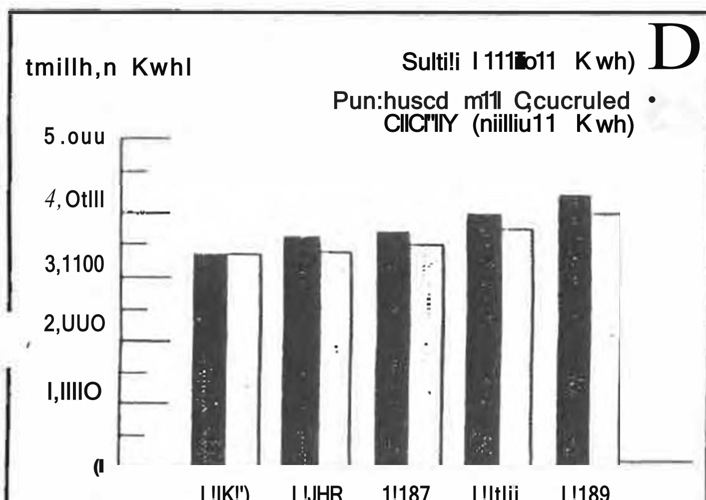
NI.P genc.-atcs atpproximalcly 10% of ilti r::lccl'ric supply und dC!◆end◆ ◆ntirt!ly on Jl_ydro lo supply ◆he balance. NLP s al.11llty lo add to 1ls own general1ng capltcity israther reslricU-d, duo to limited.economically available sights lcrt lo develop on the Island and due lo Hydro's virtual monopoly on wutcr resources. Therefore conlinued growlh in electric dcmt1nd on the Island wili mean further dependency on II)'dro. Hydro's possible expansion programs will likely he in Upper Churchill La◆riulor. 'l'his could evolve inlo higher rates ro; re!ndcnce on th<: Island, due lo high lransmiuion custs. As H result, even inc.xpensive electricity generated on the Mainland, lranslutes info higher rales on the Island. The cost lo establish 1u1 cl◆clricul link between lhe Mainlatnd 1md the bland will bo in the neighbourhood of S2 billion and not cxpccled lo be developed until lhe lute 1990's.

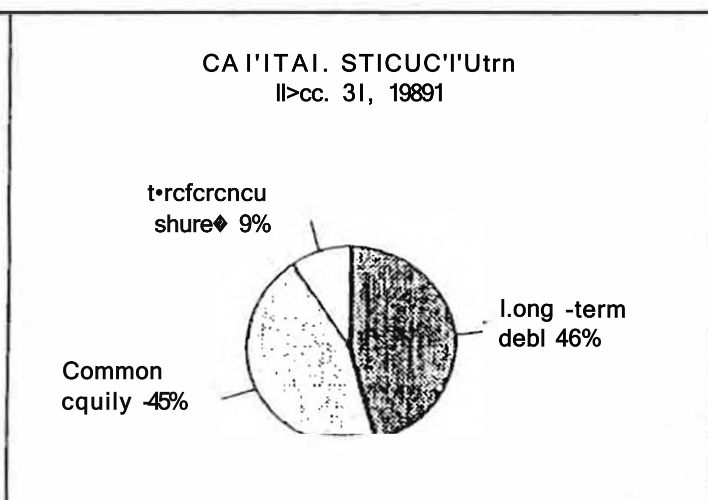
Itegulation

'l'he Company is regulated by ll>e Board or Commissioners of Public Utilities of Newfoundland r'l'UC") in reg11r◆◆ to rllles, capilal expenditures, 1esuence of securities, lums of s◆rvicc, and related mutters.

'l'hc Compuny iii currenll)' allowed a rate of return on avernge couunun cquily within 111naulhoriztd range of 13.70% lo 14.20'/t. The delermined overall return on ti verage rate bllsc i◆ hctwtien I I.58% and I J.95'1..

In early 1990, Hydro filed 11n application with the Public Utilities Hourd for an increttsc in rates it chargcs. Ai; a result, NI.P lilcd an a11plication wilh the PUC lo 1111sl- through the cnlirt ir1crcuc from llydro. 'fhis 111111lcuiu11 wu!l ipJU-11\c:d und us u result NI.I' was a lowed a -1.6% incrcul;c c:ffcclivt Jul y I, 1990'.





Credit Analysis

Itating Comment

In 1989, rcvcnm: und net cumin11s im1>roved by 4'1, Mld 10% lo $278.3 million und $24.4 million respectively. This growth rcncclli tl 2.5% growth in customer l,1ulc und u S.8'1. incnillse in elvctric sale!!.

In 1989, NI.P's dcl,t:cquily rttliu incrvascd lo 49:51% f 'um 47:53%, reOccting a $40 million Bond issuc in the third quarLer of 1989. Over the pa!il fiCJ ye11rs, ncl earnings h1tvc r1:1rged between 520-25 million 1mnu11lly while debt hH·ds h11vc increased from $138 million in 1985 to $191 million in 1989. 'l'his luts resulted in a gratlual decline in inhirust cuvcruge from 3.3 times in 1985 to 2.8 limes in 1989.

Preferred divid1.md covcnlge has graduully improved from 5.6 tin1cs in 1985 to 9.6 times in 1989. This reOecls the gradual rei.lcmpliun of prcforred equity, brought on hv unfa\•ourublc changes in Lai legi.slulion.

C1t;h flow remains salii;fuctory al S4-1. 2 million while cush now as 11 1-01conrh1ge Clf lolul dchl declined ,;lightly lo 23'1.

Ovcrull, NI.I' m1:1iulaim; a stublo lnn11ci11l po1,ilion, ,1s I rcsull, lhc First Mortgage Bonds nnd Hcner11l l\lortgagc Bonds ;uo considered lo he uf Kood quality und an: rutctl A. The Prcfoned Sharell! huvu hiwn u11grudcd 111 P•211Hghl from P-2, tluc lo un improvin� coverage rutiu.

n1-;u'J'OUTSTANUING 1$0001

1-iro& M ₐ t. 5't·. HUrC J;	Y11a1·uf l ıUU!	Mulur i▸	Ori..inul A	,1/u l II IIC:. 31/89
II"-	1971	1511:.!":11	l111111	1:1,192
11 1⁄411.	19'Hi	11,O!11 i	110,11110	116,i II
11 1/:I°,	1979	15/llP.l9	15,1100	$4,S3:.I
17JI4'.L	NK!	alll/91J	,',,SOO	$1,,97 6
l:l7llli1,	19114	01l0:r..195	17,5011	$7,350
11 l,ƒ.:/;-	l!1115	U1/12105	I I,UOO	114,1150
111/8'1,	1987	I Ii'I :J/117	$40,000	1:19,600
5 J/tI'J	I 9ill	01/U II	ll.S. $l ,fllltl	I'd11.$l,790
i 1⁄4(,	1971	15112/lJ:.!	ll.S. $11.lJU	CJn.$7,919
10.55'"•	1911!!	ClK/111/14	1411,0h	SJ9,176

Ucneml Mgt. lu11ds

9 1/l�	1970	15.'IU:!iU	,:r...uou	l:l,411
1111-N	1!174	Ulll:!!94	its.uon	11 -4,5tl9
III Il:.!'«.	1911	10,0197	120,0011	$17,IH

Lead Underwriu�rs:
Wood Gundy
Burns Fry

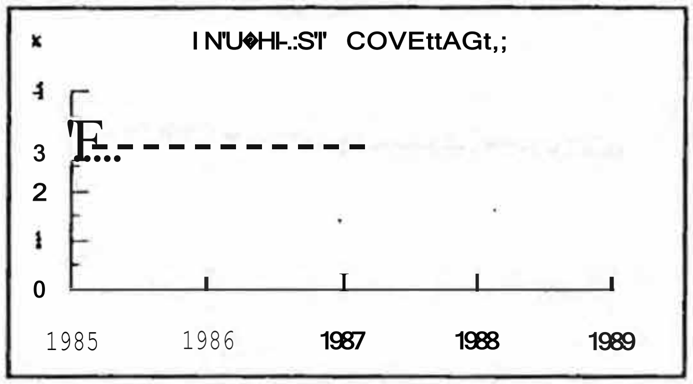
Trustee:
Monlrcul Trnst Company

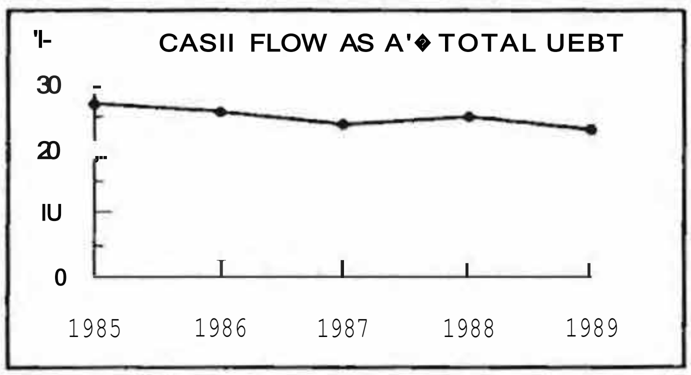
HATING CI..ASSWICATIONS

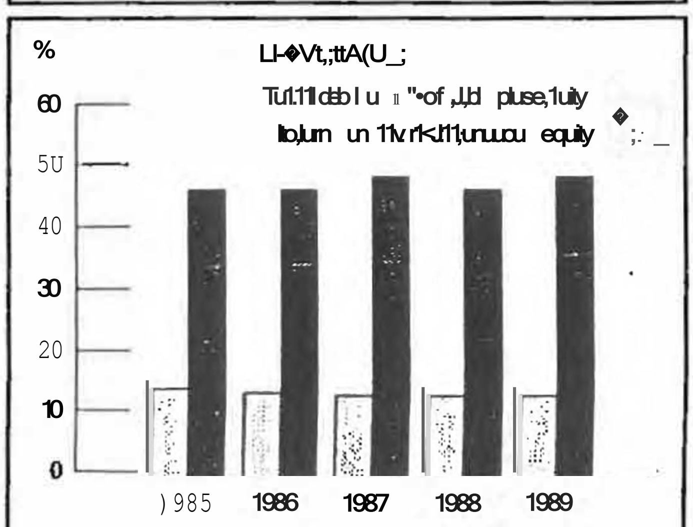
l•in1l Mortg11gc bonds	A
Gcncrlll Morlgugc Bond!!	A
Preferred Shares ....•	P·2(High)

HATING HISTOKY

Morlgage Honda	1972 - 80	B + +
	1981 - present	A
Preferred Shares	1983 - 90	p.2
	Sept./1990 ..	P-2(lligh)







CONSOLIDATED STATEMENT OF EARNINGS

For the Period Endin◆ December 31
($ OOOs

	1985	1988	1987	1988	1989
REVENUE					
Sales	244,007	245,427	250,960	267,215	276,823
o,her Income	0	0	0	1,122	1472
	244,007	245,427	250,960	268,337	278,295
EXPENSES					
Operating Expenses	178,611	177,673	186,913	195,398	205,683
Depreciation & Amortization	15,312	16,555	17,362	19,046	20,955
Interest • Long Term Debt	13,658	15,028	13,876	17,865	17,671
• Ocher	1,691	1,215	2,770	1,091	2,071
Allowance for funds	(294)	(305)	(156)	(342)	(1,041)
Other Eapenses (Net)	243	304	◆81	378	417
	209,221	210,470	221,146	233,436	245,756
PRETAX INCOME	34,786	34,957	29,814	34,901	32,539
Income Taxes	14,382	14,564	11,141	13,016	10,448
Minority Inlcrest	0	0	0	0	0
Unusual Items	(453)	69	(1,822)	(347)	(2,357)
Equity in Earnings	0	0	0	0	0
INCOME BEFORE EXTRA. ITEMS	20,857	20,324	20,495	22,232	24,448
Extraordinary Item(s)	0	0	0	0	0
NET EARNINGS (LOSS)	20,857	20,324	20,495	22,232	24448

CONSOLIDATED BAlANCE SHEET

As at December 31
($ 000s)

ASSETS

	1985	1886	1987	1988	1989
CIIHRENT ASSETS					
Cash & Oilier	7,181	3,511	5,066	2,784	5,321
Accounts Receivable	25,364	28, t 13	29,635	34,820	32,761
Inventories	6,192	5,675	5,033	6,089	7,052
TOTAi, CURRENT ASSETS	38,737	37,299	39,734	43,693	45,134
rixcd Assets (Ncl)	311,976	326,301	346,883	372,920	407,115
Invcst men ls	0	0	0	0	0
Other Assets	2,691	3,106	3,058	2,664	3,279
TOTAL ASSETS	353,404	366,706	389.675	419,277	455,528

LIABILITIES ANO SHAREHOLDERS' EQUITY

	1985	1886	1987	1988	1989
CURRENT LIABILITIES					
Short Term Debt	16,998	29,650	19,917	25,088	25,619
Accounts Payable	27,568	28,340	29,71 t	34,745	38,382
Olher	6,334	7,978	6,385	9i784	8,998
TOTAL CURRENT LIABILITIES	50,900	65,968	56.013	69617	72,999
Long Term Debt	120,510	112,342	140,632	138,724	164,959
Deferred Income Taxes	9,300	9,155	9,209	8,974	8,908
Minority Interest	0	0	0	0	0
Olhcr Liabilities	17,400	17,251	15,204	15,774	13,924
SIIAREIIOLDEHS• EQUIn'					
Share Capital • Preferred	37,282	36.067	34,876	33,670	32,595
• Commoa	44,507	56,737	36,794	47,674	48,366
Retained Earnings	1'3,505	§9,186	96,947	104,844	113.757
	155,294	161,990	168,617	186,188	194,?◆9
TOTAL LIABILITIES & EQUIn'	353,404	366,706	389.675	419,277	455,528

SELECTED SOURCES AND USES OF FUNDS

For lhe Period Ending December 31 ($ 000s)

	1985	1986	1987	1988	1989
Cash Flow frum Operations	36,71 I	36,272	38.291	41,096	44,234
Proceeds from LT. Debt Jssues	14,712	0	41,383	0	39,447
Proceeds from Equily lssue.s	2,032	10,757	737	10,879	712
Sale or Jnveslmcnts/Assets	0	0	0	0	0
Capital E:itpendilure (NET)	33.117	32,109	39,104	46,345	56,513
Invcst ments/ Acquisitions	0	0	0	0	0
Repa}menl of Debt	2,733	6,215	8,671	13,266	2,313
Conversion/Rcdt:mption or Pfd. Shares	1,209	11,215	1,191	1,205	1,076
Dividends Paid	12,609	13,428	IJ,414	14,335	15,535
Net Chnnge In Working CapiLul	◆; i	(16,506)	12,390	(9,645)	(1,941)

CAPITALIZATION{$ 000,OC>Os)	1985 %	1986 %	1987 %	1988 %	1989 %
Short Term Dl:bt	17.0- 6	29.7• 9	19.9- 6	25.1- 7	25.6- 6
Long Term Debt	120.5- 40	112.3- 36	140.6- 42	138.7- 39	165.0- 42
DefcrreJ Taxes	9.3- 3	9.2· 3	9.2· 3	9.0· 2	8.9- 2
Minority Interest	0.0- 0	0.0· 0	0.0- 0	0.0- 0	0.0- 0
Equi1y - Preferred	37.3- 12	36.1 • 12	34.9- 10	33.7- 9	32.6- 8
- Commlln	11 B.0- 39	125.9- 40	133.7- 40	152.5- 42	162.1- 41
TOTAL	302.1-100	313.1-100	338.4-100	359.0-100	394.2-100

COVE:RAGE HATIOS					
Net Tangible As◆i:ls	2.28x	2.39 x	2.14 x	2.37 x	2.12 x
Total Dcht:Equity	47:53%	47:53%	49:51%	7:53%	49:51%
lnlcrc51 Co..-crage	3.3 x	3.1 x	2.9 x	2.9 x	2.B x
C.ish Flow % Tolal Debt	26.7%	25.5%	23.9%	25.1%	23.2%
Preferred Dividend Coverage	5.6x	6.2x	7.3 x	8.3 x	9.6x
Ffd. & Common Div. Coverage	1.7 X	1.5 x	1.5 x	1.6 x	1.6 x
All fix-cd Charges	2.3 X	2.3 x	2.3 x	2.3 x	2.3 x

LI(JUIDITI' RATIOS					
STD % Total Dehl	12.4%	20.9%	12.4%	15.3%	13.4%
Current Liah. % Revenue	20.9%	26.9%	22.3%	25.9%	26.2%
Avail. C.f'. % Const.	60.9%	16.9%	38.4%	26.5%	44.8%

PROFITARILJ1Y RATIOS					
Net Margin	8.5%	8.3%	8.2%	8.3%	8.8%
Asset Turnover	0.69X	0.67)(	0.64:.:	0.64x	0.61><
E.B.I.T. % of Total Assets	13.8%	13.6%	11.7%	12.7%	11.5%
Return on Avg. Common Equity	15.2%	14.0%	13.6%	13.7%	13.9%

OPERA.TING STATISTICS					
Sources of energy (millions of kwh)					
Purchased	3,204	3,227	3,370	3,572	3,916
Generaled	327	391	335	419	321
Total	3,531	3,618	3,705	3,991	4,237
Sales (millions of lcwh)	3,331	3,411	3,504	3,738	3,993
Customers (year.end)	172,119	175,631	179,612	184,055	1BB,575
Employees	938	905	914	926	963

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