ENERGY COMES WITH THE TERRITORY

2011 Business and Financial Report

boundless.

nalcor energy

key accomplishments at a glance

SAFETY: TO BE A SAFETY LEADER

- Reduced lost-time injuries by 50% over 2010.
- Reported 7,135 safety-related observations through the Safe Workplace Observation Program (SWOP).
- Reduced days-lost by 84% over 2010.
- Launched a BeSafe Safety Coaching framework and workshop, delivered to approximately 150 employees.
- Delivered a public education campaign on power line safety.

ENVIRONMENT: TO BE AN ENVIRONMENTAL LEADER

- Nalcor Energy and its CEO Ed Martin named one of "Canada's 2012 Clean50 and Clean16" in recognition of the company's environmental efforts.
- First three projects commenced through Hydro's Industrial Energy Efficiency Program, expected energy savings of 3.6 GWh per year.
- Churchill Falls completed 100% of its Environmental Management System targets and milestones.
- Continued development of an ISO 14001 compliant Environmental Management System at Menihek, Exploits Generation, Oil and Gas and Bull Arm Fabrication.

BUSINESS EXCELLENCE: THROUGH OPERATIONAL EXCELLENCE, PROVIDE EXCEPTIONAL VALUE TO ALL CONSUMERS OF OUR ENERGY

- New Dawn Agreement, including an Impacts and Benefits Agreement, ratified by Labrador Innu and finalized by all parties.
- Secured commitment for Federal Loan Guarantee for Lower Churchill Project, Phase One.
- Oil and Gas exploration strategy completed, offering tremendous potential to develop new resources in the offshore.
- Entered into sublease agreement with ExxonMobil Canada Properties for Hebron Project construction at the Bull Arm Fabrication site.
- Hydro achieved 98.3% winter availability for key electricity generating assets, exceeding its target of 96%.
- First oil achieved from the West White Rose pilot project and the Hibernia Southern Extension.
- Significant capital work completed in Churchill Falls as part of a long-term renewal program of production assets.
- Formed internal technical councils as part of the company's asset management program.

PEOPLE: TO ENSURE A HIGHLY SKILLED AND MOTIVATED TEAM OF EMPLOYEES WHO ARE COMMITTED TO NALCOR ENERGY'S SUCCESS AND FUTURE DIRECTION

- Employee recognition programs resulted in 3,000 peer recognitions and eight employees presented with prestigious President's Awards.
- Finalized a Diversity and Inclusion Strategy and established an internal Diversity Council.
- Completed enhancements to apprenticeship program for all trades, including an updated Apprenticeship Workbook.

COMMUNITY: TO BE A VALUED CORPORATE CITIZEN IN NEWFOUNDLAND AND LABRADOR

- Awarded over $50,000 in scholarships to Newfoundland and Labrador youth.
- Employees donated more than $63,000 to charitable organizations, supported by the company's Employee Matching and Volunteer Contribution Programs.
- Over 180 employees volunteered with 15 community groups and charities throughout the province during Nalcor's first annual Acts of Kindness Week in April 2011.

key financial highlights

Years ended December 31 (millions of dollars)	**2011**	2010
Revenues	**729.9**	620.1
Net income	**126.7**	77.5
Capital assets, net	**2,412.8**	2,237.9
Long-term debt	**1,131.5**	1,136.7
Shareholder's equity	**1,427.6**	1,265.4
Dividends	**-**	-
Capital Expenditures	**254.6**	196.3
Debt to capital	**38.5%**	42.5%
Return on capital employed	**10.9%**	8.7%
Funds from operations to debt	**20.0%**	13.5%

VISION

Our vision is to build a strong economic future for successive generations of Newfoundlanders and Labradorians.

VALUES

At Nalcor Energy, our employees share a set of values that shape how we do business every day. Our core values set common direction on how to make decisions with a sense of pride and leadership. We recognize that it is not only what we achieve, but how we achieve it that truly makes us proud of our accomplishments. We believe our core values develop a culture based on high standards and expectations. We feel empowered to challenge the norms and seize new opportunities while working towards our corporate vision.

Nalcor Energy is a proud, diverse energy company, whose people are committed to building a bright future for Newfoundland and Labrador, unified by our core values.

Open Communication
Fostering an environment where information moves freely in a timely manner

Accountability
Holding ourselves responsible for our actions and performance

Safety
Relentless commitment to protecting ourselves, our colleagues and our community

Honesty and Trust
Being sincere in everything we say and do

Teamwork
Sharing our ideas in an open and supportive manner to achieve excellence

Respect and Dignity
Appreciating the individuality of others by our words and actions

Leadership
Empowering individuals to help guide and inspire others

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HEAD OFFICE

NALCOR ENERGY
Hydro Place. 500 Columbus Drive
P.O. Box 12800. St. John's. NL
Canada A1B 0C9

T. 709.737.1440
F. 709.737.1800
E. info@nalcorenergy.com
W. nalcorenergy.com

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MESSAGE FROM THE CHAIR

Nalcor Energy is leading the development of Newfoundland and Labrador's energy resources. We have put our passion for the future prosperity of this province into developing a sound vision – one that ensures we are meeting the current and future energy needs of the people of Newfoundland and Labrador in a safe and sustainable way.

The role of Nalcor's Board of Directors is to oversee the company's business activities on behalf of our Shareholder, the Province of Newfoundland and Labrador. The Board is responsible for reviewing Nalcor's performance, planning for the company's future, establishing acceptable levels of risk and ensuring our business operations benefit the economic security of current and future generations.

We are confident with the rigorous planning that drives the company's asset management. Nalcor has made excellent progress in executing our long-term business plans and financial strategies, placing us in a solid financial position for future investment in our energy business.

Significant milestones were achieved on the Muskrat Falls development in 2011. The Board is encouraged to see the level of interest and dialogue surrounding this important development. This level of scrutiny aligns with the principles the Board implements in its direction and oversight of all Nalcor's operations.

Nalcor continues to establish its role in advancing exploration of Newfoundland and Labrador's offshore by investing in a large-scale 2D seismic survey in 2011. Also in 2011, Nalcor entered into a sublease agreement with ExxonMobil Canada Properties for construction related to the Hebron Project at the Bull Arm Fabrication site. In addition to Nalcor's working interest in three offshore developments, these initiatives further support development of the province's oil and gas industry.

In 2011, I was pleased to assume the role of interim Chair of the Nalcor Energy Board of Directors. I thank the past Chair, John Ottenheimer, for his dedication to the Board. It is an exciting time for Nalcor's Board members, as we continue on a significant journey to secure a dependable power supply for the province and enter into a new era of energy development.

We have strong leadership and alignment with our Shareholder. Nalcor is well prepared and experienced to oversee the development of the Muskrat Falls Project. Our employees have the expertise and passion to lead us into the future – where we see this province as leaders in the global energy sector.

Cathy Bennett
Interim Chair, Board of Directors

MESSAGE FROM THE CEO

2011 was a busy and invigorating year at Nalcor Energy. Our drive to achieve our performance targets continues to be anchored by our strategic long-term vision. I commend all employees across the company who demonstrated passion and dedication while contributing to our overall success.

We made great strides in 2011 across all our lines of business. We are closing in on the important recommendation of how to best meet our province's future electricity needs. Our responsibility lies in ensuring that we make strategic investments for the benefit of Newfoundlanders and Labradorians and for the prosperity of future generations. In June, we celebrated an important milestone with the announcement of first oil from the Hibernia Southern Extension. As a partner in three offshore oil developments in Newfoundland and Labrador, we play a key role in securing economic value from the development of our offshore for the benefit of future generations.

RELENTLESS DEDICATION TO SAFETY

We continue our journey towards a world-class safety culture. In 2011, we gained noticeable traction in safety performance. I am proud of our success, such as a 50 per cent reduction in lost-time injuries, and I see a positive trend emerging year over year throughout our safety programs.

We continue to leverage our core safety programs, particularly in the area of work methods and the work protection code. These fundamental programs help protect our employees and create an environment where nobody gets hurt. We are heading in the right direction. It is essential that we maintain a relentless commitment to safety and continue to reinforce the message to every employee to take personal responsibility for their safety and the safety of their co-workers.

PREPARED TO MEET THE CHALLENGE

Nalcor is focused on making the right investments at the right time on the right assets to ensure safe and long-term operational excellence. We have implemented a consistent framework for asset management across all lines of business and extract value from our work in this area by taking a long-term strategic approach. We know what needs to be done and we have the right asset management and project execution processes in place to ensure our assets are managed and maintained effectively for current and future generations of Newfoundlanders and Labradorians.

We also remained focused on strengthening and solidifying the company's financial position. One way we measure our financial strength is through our debt to equity ratio. We now have high equity levels and the lowest debt levels in 30 years, which puts us in a solid position for growth. This level of financial strength positions us to execute on strategic business activities and allows us to make appropriate ongoing investments in infrastructure to ensure reliable service for our customers.

Over the past few years, we have strengthened our efforts to advance exploration of Newfoundland and Labrador's offshore. Our investment in a regional oil seep mapping and interpretation study in 2010 provided a foundation to pursue a partnership with an international data and exploration company to complete a large-scale 2D seismic survey of offshore Newfoundland and Labrador. These opportunities will help determine the resource potential available in our province, reduce uncertainty and overall exploration risk, and ensure oil and gas resources are harnessed for future economic benefit of Newfoundlanders and Labradorians.

An important advancement in the industrial fabrication industry in Newfoundland and Labrador was made in 2011 with the signing of a sublease agreement between ExxonMobil Canada Properties and Nalcor Energy Bull Arm Fabrication for occupancy of the Bull Arm site for the Hebron Project construction. Nalcor will continue to ensure this world-class fabrication site is used to maximize benefits to the province from future construction and fabrication projects.

MEETING FUTURE ENERGY NEEDS

Newfoundland and Labrador Hydro has the responsibility to assess and recommend supply options to meet the province's growing energy needs. In 2010, Hydro determined new generation would be required to meet a capacity shortfall in 2015 and an energy shortfall in 2021. We examined a broad selection of alternatives and determined a transmission interconnection between the island of Newfoundland and Labrador bringing power from a generating station in Muskrat Falls was the least-cost option for electricity consumers and would also provide surplus power to support industrial growth in Labrador.

On Nov. 18, the Innu Nation signed the New Dawn Agreement and in August the federal government committed to a federal loan guarantee. As well, we have achieved several other milestones needed for Decision Gate 3 (DG3), project sanction. We will be in a position to make a sanction recommendation to our Board and Shareholder, the Province of Newfoundland and Labrador, after we update commercial arrangements, project capital costs, schedule and economic analyses in preparation for DG3.

THE ENERGY BEHIND OUR ENERGY

Our success is truly anchored in our people. Our employees have a strong spirit – a strong energy – that drives our work across all our lines of business. Sharing that energy with each other influences the important work we do every day. Without the expertise of our skilled and capable workforce, we could not make such strides in the energy sector as we have in our 50-year history.

We share a common vision, common values and shared goals. Together, each and every employee contributes to building something that will change the face of Newfoundland and Labrador. Every day we focus on actions that take us from being a good company to a great one, and our focus on employee engagement is pushing us to create a great place to work.

We embrace the individuality and ideas of our employees, and believe that the diversity of background and experiences enriches our company and contributes to an innovative, high performance environment.

Most importantly, we are committed to providing a safe and healthy workplace. Our safety journey is the most important piece of work we do at Nalcor and our dedication to safety gets our employees home safely to their families every day.

LOOKING FORWARD

I thank the Board of Directors and our Shareholder, particularly the Department of Natural Resources, whose contributions, insights and expertise is appreciated and valued during a time of growth in our company.

Ed Martin
President and CEO

CORPORATE PROFILE

NALCOR ENERGY IS NEWFOUNDLAND AND LABRADOR'S ENERGY COMPANY. HEADQUARTERED IN ST. JOHN'S, THE COMPANY'S BUSINESS INCLUDES THE DEVELOPMENT, GENERATION, TRANSMISSION AND SALE OF ELECTRICITY; THE EXPLORATION, DEVELOPMENT, PRODUCTION AND SALE OF OIL AND GAS; INDUSTRIAL FABRICATION; AND ENERGY MARKETING.

Focused on sustainable growth, the company is leading the development of the province's energy resources and has a corporate-wide framework which facilitates the prudent management of its assets while continuing an unwavering focus on the safety of its workers and the public.

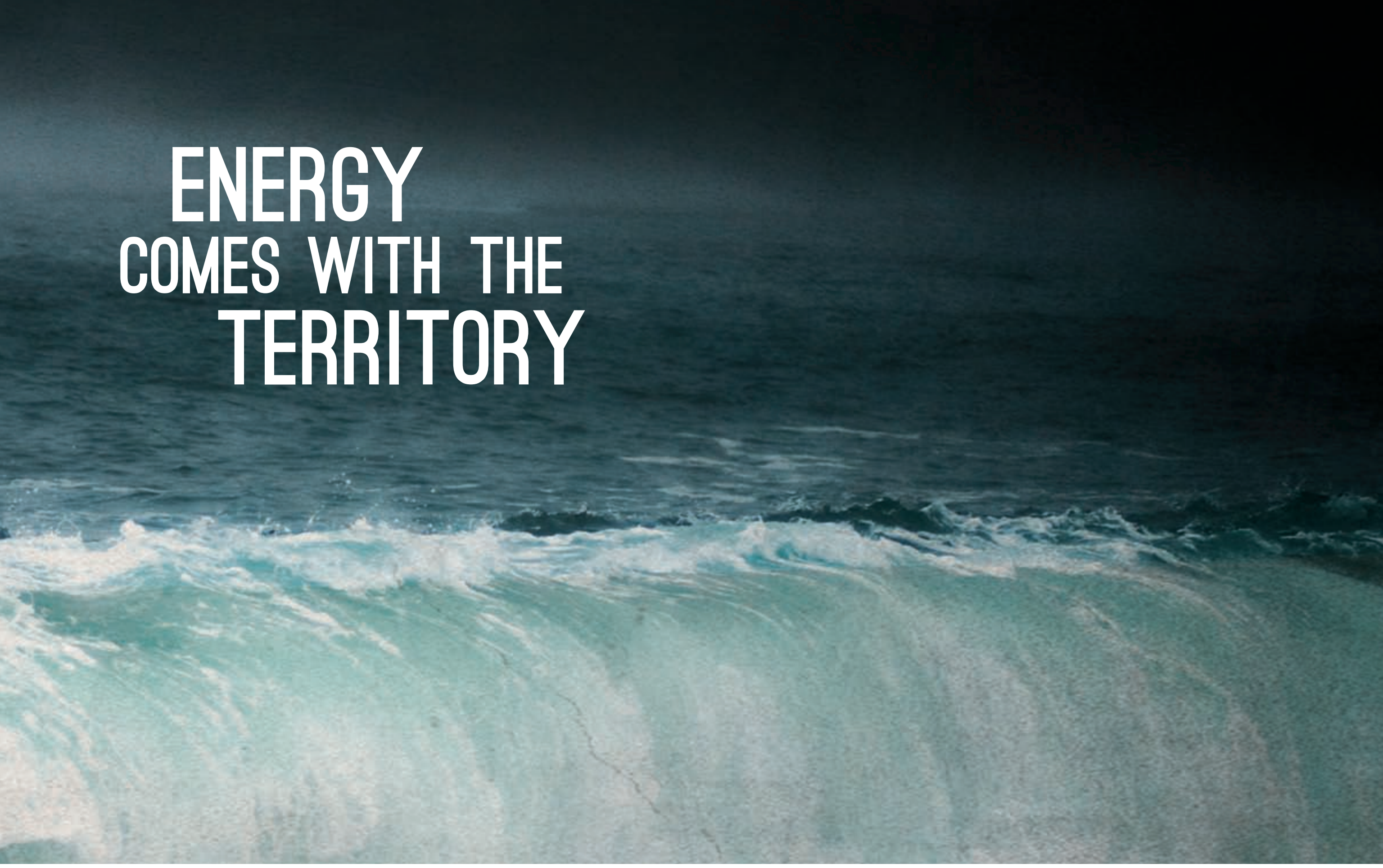
Nalcor currently has five lines of business: Newfoundland and Labrador Hydro, Churchill Falls, Oil and Gas, Lower Churchill Project and Bull Arm Fabrication.

NEWFOUNDLAND AND LABRADOR HYDRO

As the province's main electricity provider, Hydro is focused on providing a safe, reliable and cost-effective electricity supply to meet current electricity needs and accommodate future growth. Hydro's primary business is to generate and deliver electricity in Newfoundland and Labrador to utility, industrial, residential and commercial customers in over 200 communities across the province.

CHURCHILL FALLS

Nalcor's flagship operation in Churchill Falls is one of the largest underground hydroelectric powerhouses in the world with a rated capacity of 5,428 megawatts (MW). The Churchill Falls generating station provides clean, renewable electricity to millions of consumers throughout North America. A significant portion of that electricity is being sold to Hydro-Quebec through a long-term power purchase agreement with additional sales to Hydro and Twin Falls Power Corporation to



meet the needs of residential and industrial customers on the Labrador Interconnected electricity system.

OIL AND GAS

Nalcor is currently a partner in three developments in the Newfoundland and Labrador offshore oil and gas industry: the Hebron oil field, the White Rose Growth Project and the Hibernia Southern Extension. Oil and Gas has also developed an extensive strategy to help advance exploration of the Newfoundland and Labrador's offshore, and is currently partnering with international interests to execute an extensive 2D seismic program as part of this plan.

LOWER CHURCHILL PROJECT

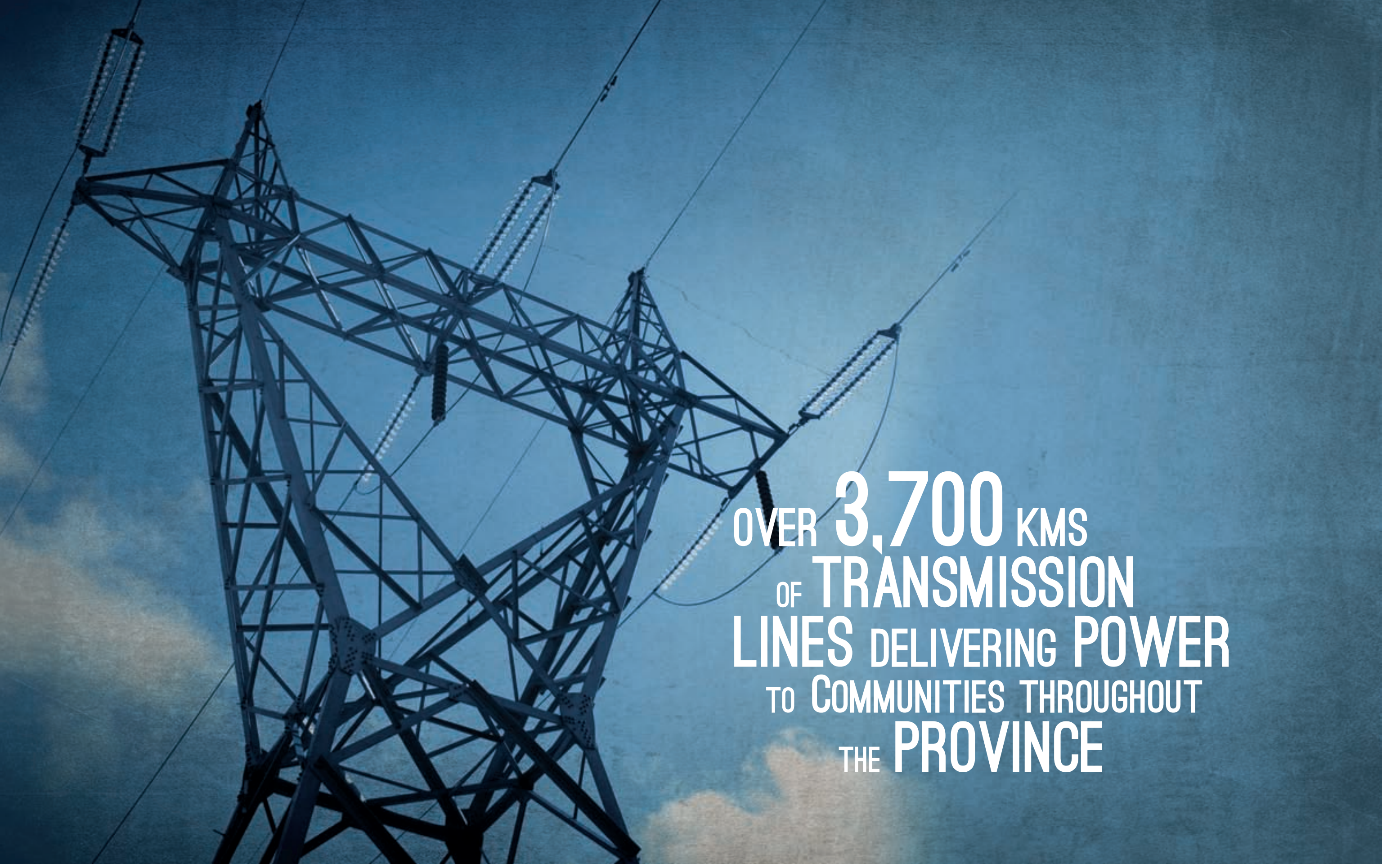
The Lower Churchill Project is one of the most attractive undeveloped hydroelectric sites in North America and is a key component of the province's energy warehouse. The Project's two proposed installations at Gull Island and Muskrat Falls will have a combined capacity of over 3,000 MW. The clean, stable, renewable electricity provides the opportunity for the province to meet its own domestic and industrial needs in an environmentally-sustainable way, and also export electricity to other jurisdictions where the demand for clean, renewable energy continues to grow. Nalcor is progressing Phase One of the development, Muskrat Falls, and associated transmission links to Newfoundland and Nova Scotia.

BULL ARM FABRICATION

Bull Arm Fabrication is Atlantic Canada's largest fabrication site. Close to international shipping lanes and Europe, this site has unobstructed, deep water access to the Atlantic Ocean. This world-class facility spans over 6,300 acres and has fully integrated and comprehensive infrastructure to support fabrication and assembly of three key project functions simultaneously, in three separate theatres: Topsides Fabrication and Assembly; Dry-dock Fabrication and Construction; and Deepwater Construction and Integration Site.

ENERGY MARKETING AND OTHER ENERGY ACTIVITIES

In addition to Nalcor's five lines of business, the company is involved in energy marketing and other energy activities, including non-regulated electricity generation, wind energy, and research and development. Nalcor's current energy marketing portfolio includes recall power not required by Hydro and will continue to grow over the coming years.



NEWFOUNDLAND AND LABRADOR HYDRO

FOR MORE THAN 50 YEARS, HYDRO EMPLOYEES BUILT AND MAINTAINED THE PROVINCIAL ELECTRICITY SYSTEM IN A SAFE, RELIABLE AND COST-EFFECTIVE MANNER. With electricity assets and employees spanning the province, a commitment to safety and asset management is critical to serving its customers effectively.

Hydro is focused on keeping its workers safe. A critical program is work methods and associated Task Based Risk Assessments (TBRA), which provide information to workers on how to perform a critical task safely. In 2011, Hydro finalized an updated list of all job tasks a worker is asked to perform and identified those which are critical. Hydro exceeded its 2011 target of completing fifty per cent of work methods and TBRAs for critical tasks.

Hydro also made enhancements to its electronic work methods database. This system allows workers to easily access the multitude of tasks necessary to operate the electricity system safely and smoothly. The database also ensures employees can take an active role in providing feedback and suggestions for ongoing improvement to work methods.

From a public safety perspective, Hydro is concerned over the steady increase of power line contacts over the past five years. In 2011, Hydro focused public education of this critical issue on contractors and heavy equipment operators through the use of radio advertising, social media, targeted mailing campaigns, presentations and information sessions. Work in this area will continue in 2012.

A key challenge in the Canadian utility industry is electricity infrastructure renewal. As with other utilities, many of Hydro's assets are over 40 years old and require significant investment to ensure a continued safe and reliable supply of electricity. Hydro's long-term asset management framework addresses this complex issue by ensuring a strategic approach to understanding the condition of its assets, followed by appropriately planned life extension or replacement projects.

The 40-year old Holyrood Generating Station is a critical generation source on the island of Newfoundland and must be maintained reliably to meet consumers' increasing electricity demands. In 2011, the first phase of a Condition Assessment and Life Extension Study was completed to evaluate the condition of all components of the plant and determine work that may be required to extend the plant's reliable and useful life into the future.

Investing in infrastructure and maintaining assets in sound condition is important to ensuring electricity is available year-round and especially during peak seasonal demand. A key corporate measure of performance and reliability for Hydro's generating assets is availability during the winter season. In 2011, the island generating facilities achieved over 98 per cent winter availability, exceeding a target of 96 per cent.

Hydro is also dedicated to environmental stewardship and energy conservation. The takeCHARGE energy conservation program made several advancements in 2011 in partnership with Newfoundland Power. This program offers rebates on insulation, ENERGY STAR® windows and high efficiency and programmable thermostats for residential customers, and lighting incentives for commercial customers. In 2011, Hydro also launched a pilot incentive program for retailers to encourage them to sell ENERGY STAR windows and promote the takeCHARGE ENERGY STAR window program.

In 2011, Hydro approved the first three capital projects in its Industrial Energy Efficiency Program under takeCHARGE. These projects include feasibility study assistance and capital upgrades. Energy savings will total 3.6 gigawatt hours (GWh) per year when all three projects are completed, equivalent to reducing oil usage at the Holyrood Generating Station by approximately 5,800 barrels per year.

HOLYROOD PLANT EMPLOYEES VOLUNTEER AT THE BREAKFAST CLUB AT ST. EDWARD'S SCHOOL IN KELLIGREWS, NL.

Always on in our communities

HYDRO HAS A LONG HISTORY OF GIVING BACK TO THE COMMUNITY AND MAKING A DIFFERENCE IN THE LIVES OF OTHERS. Employees at the Holyrood Generating Plant hold fundraising events during Hydro's annual Safety and Health Week. Through fundraising efforts and matching contributions from Hydro, employees at Holyrood have raised over $15,000 since 2005 for the school lunch programs at St. Edward's Elementary in Kelligrews and Holy Cross Elementary in Holyrood.

Program administrators say these donations have gone a long way in ensuring students start their day out right with the energy to learn. This giving effort is just one of many community donations provided by the Holyrood plant to other worthy causes in the Conception Bay South area.

CHURCHILL FALLS

THE CHURCHILL FALLS GENERATING STATION IS ONE OF THE LARGEST UNDERGROUND HYDROELECTRIC POWERHOUSES IN THE WORLD WITH 5,428 MEGAWATTS OF CAPACITY USED BY MILLIONS OF CONSUMERS IN NORTH AMERICA. In 2011, the generating station produced over 33 terawatt hours of clean, renewable energy.

The Churchill Falls Generating Station has 11 underground turbines that harness water from the massive Churchill River in the heart of Labrador. Maintaining these turbines and related infrastructure is critical to the company's ability to provide reliable service to customers over a long-term period and support business continuity well beyond the expiry of the 1969 Power Contract in 2041.

On Dec. 6, 2011, the generating station celebrated 40 years since first power. The company places a rigorous focus on asset management and long-term planning to ensure a fully functioning plant and quality operations for another 40 years and beyond. Planning is based on thorough condition assessments of its assets, operating and maintenance experience and other key inputs.

In 2011, Nalcor Energy Churchill Falls ramped up implementation of its long-term capital investment program in support of its asset management strategy. One important project that began in 2011 is the replacement of the facility's transformer fleet over the next 10-15 years to ensure the continued long-term operation of the plant. One to two transformers will be replaced each year. In addition, work is required on the 11 underground generating units.

The extensive work on one of the generating units in 2011 has provided employees and contractors with additional knowledge and lessons learned which they will apply as they continue work on the remaining underground units and ensure this flagship operation will benefit future generations of Newfoundlanders and Labradorians.

Churchill Falls operations are environmentally governed by ISO 14001 Certified Environmental Management Systems, and this past year marked four consecutive years of completing 100 per cent of its environmental targets and milestones. One significant accomplishment is the successful completion of the five-year Construction Debris Cleanup Program. Since 2007, the company has dedicated efforts to promote recycling and recover debris from abandoned construction sites in and around Churchill Falls in an effort to reduce its environmental impact.

While asset management and the environment is a focus at Nalcor, employee and public safety is the number one priority. Working towards continued improvement and safety excellence is imperative to operational and business success. In 2007, Nalcor introduced a Safe Workplace Observation Program (SWOP) to help identify safety concerns in the workplace. In 2011, Churchill Falls employees identified areas for safety improvement resulting in the introduction of the SWOP Management Program. This program is focused on ensuring recommended follow-up actions associated with safety observations are completed in a timely manner, creating a safer workplace and community.

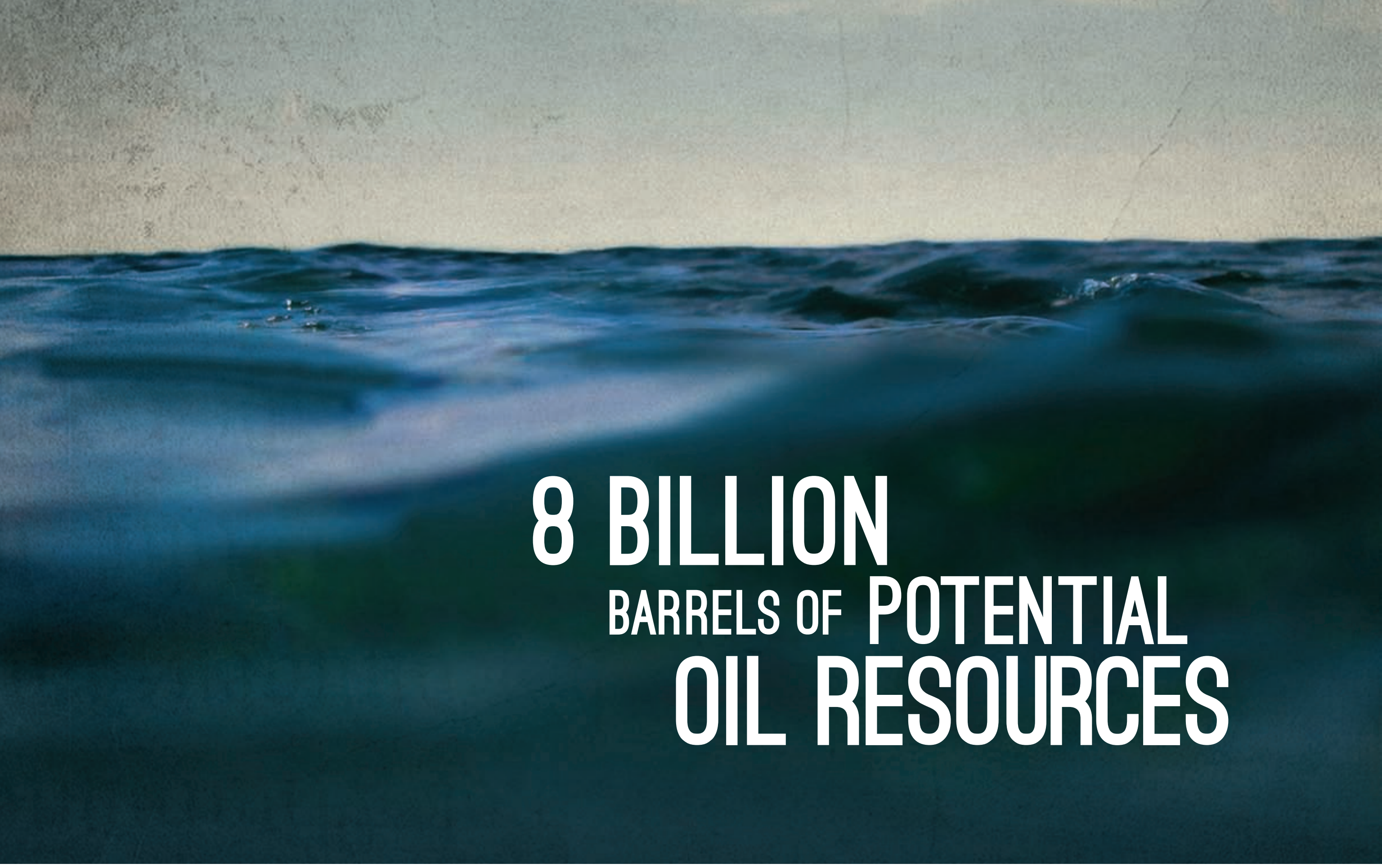
Under the terms of the 1969 Power Contract, a significant amount of the energy from Churchill Falls is sold to Hydro-Quebec. In early 2010, Churchill Falls (Labrador) Corporation (CFLCo) filed a motion against Hydro-Quebec in Quebec Superior Court seeking to change, as of November 2009, the pricing terms for the remaining term of the contract. It is the position of CFLCo that the change in circumstances since the original contract was signed has resulted in a gross inequity in the distribution of contractual benefits. In 2011, CFLCo continued preparations for trial. Court has set a trial date of fall 2013.

NEW EMPLOYEES AT NALCOR NOW WEAR GREEN HARD HATS TO INCREASE THEIR VISIBILITY.

Increasing visibility of new workers to keep them safe

SAFETY IS A DAILY FOCUS AT CHURCHILL FALLS, AND EMPLOYEES CONTINUALLY LOOK FOR NEW AND INNOVATIVE WAYS TO IMPROVE THEIR SAFETY PROGRAM. In 2011, a corporate-wide Green Hard Hat policy was first introduced for new employees in Churchill Falls where the standard hard hat colour is white. New employees have the potential to be exposed to a significant number of hazards.

Under this program, all new employees wear a green hard hat for one year to increase their visibility. This initiative allows experienced employees to more easily identify new workers and help them become familiar with policies, procedures and general safety practices around the workplace.



OIL AND GAS

LONG-TERM GROWTH AND OPPORTUNITY WERE KEY FOCUS AREAS FOR NALCOR ENERGY'S OIL AND GAS BUSINESS IN 2011. In addition to working interests in three offshore developments, the company is playing a significant role in advancing exploration of Newfoundland and Labrador's offshore by the world's oil and gas industry.

In June 2011, Nalcor announced first oil from its second development project, Hibernia Southern Extension in offshore Newfoundland and Labrador. Nalcor holds a 10 per cent working interest in the development, operated by ExxonMobil Canada Properties. First oil from the Hibernia Southern Extension Unit, as well as ongoing production from Nalcor's partnership in the White Rose Extension Project, reflect Nalcor's role in securing the province's energy future for generations to come. Nalcor is also invested as a co-venturer in the Hebron project in the province's offshore.

Beyond investments in established offshore developments, Nalcor is advancing exploration opportunities in Newfoundland and Labrador's offshore. Compared to similar resource basins around the world, Newfoundland and Labrador's offshore is vastly underexplored. Aligning with the 2007 provincial Energy Plan, increased exploration activity will help unlock Newfoundland and Labrador's offshore to support further development of the province's oil and gas industry.

In 2011, Nalcor announced a partnership and strategic investment in a large-scale, multi-client 2D seismic survey of offshore Newfoundland and Labrador, commenced by international data and exploration company, TGS, in partnership with the survey's operator, PGS. Historically in Newfoundland and Labrador, a strong positive correlation exists between investment in 2D seismic data and exploration drilling activity. Currently, about 80 per cent of the province's 2D data library is more than 20 years old. Acquiring new, better quality data will improve the industry's understanding of the offshore basins and will likely lead to more wells being drilled.

The two-year survey, which began in mid-2011 and will continue into 2012, is gathering data that is a foundation to further the province's offshore exploration and development. The seismic survey builds on a satellite oil seeps study, which was completed in late 2010 by EADS subsidiary Astrium GEO-Information Services, and covered over 1.5 million square kilometres of offshore Newfoundland and Labrador.

Nalcor's exploration program also included a 67 per cent working interest in three permits in an onshore exploration project on Newfoundland's West Coast. Through drilling two exploration wells in 2009 and 2010, Nalcor obtained one of the most extensive exploration data sets that exist for the region and gained insights that will guide future exploration activities in Western Newfoundland basins. Analysis of the data from the two drilled wells indicated that a planned third well would likely not yield additional insight, and as a result the third well was not pursued. Safety was top of mind for Nalcor, its partners and contractors throughout the exploration program on the West Coast, which was completed safely and without environmental incidents.

Nalcor's strategy for growth in the oil and gas sector aligns with the company's vision to build a strong economic future for Newfoundland and Labrador. Nalcor is dedicated to investing and promoting the province's oil and gas potential. That vision and dedication is evident in the company's role in advancing exploration, as well as its partnerships in development of the province's resources.

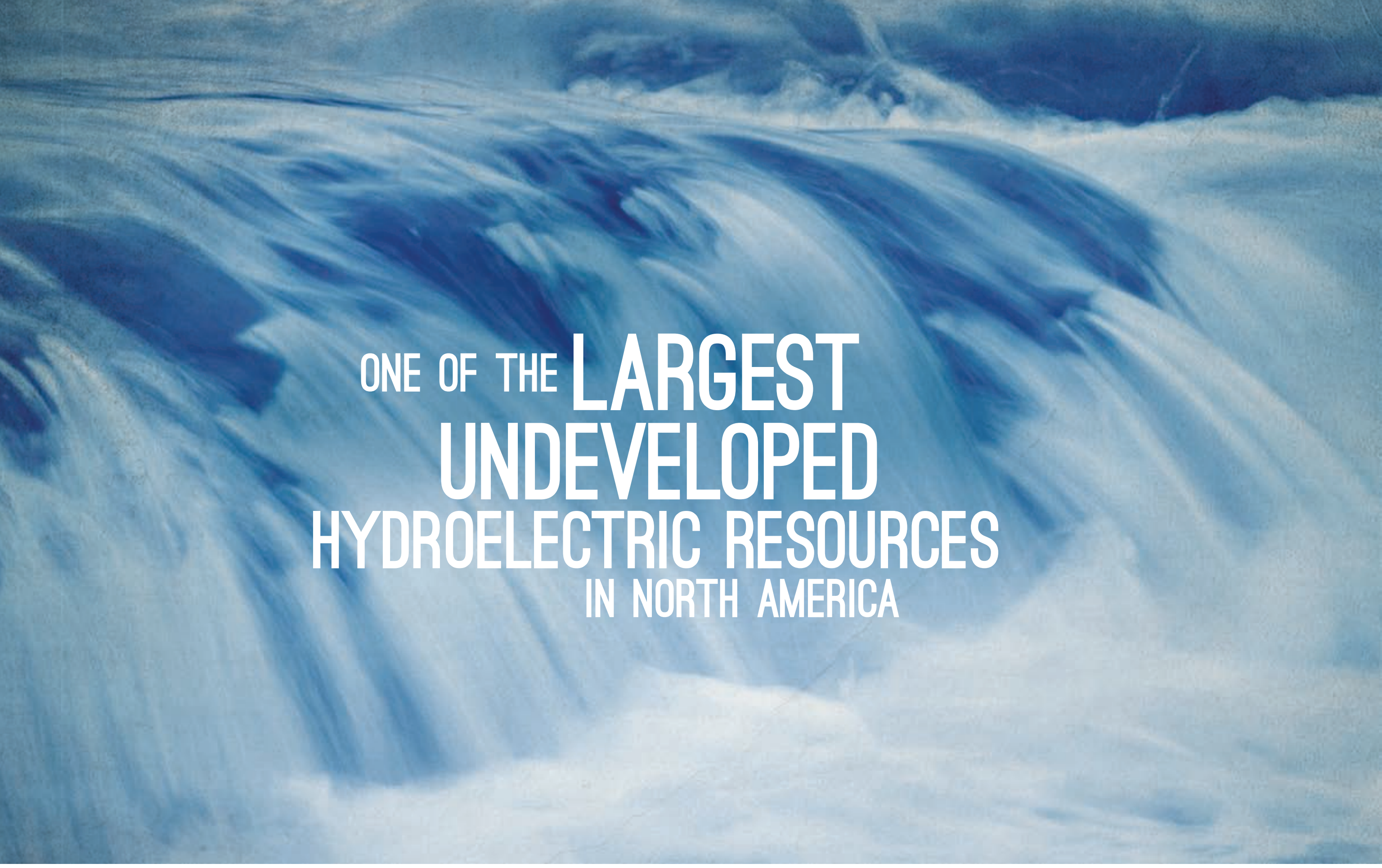
THE SANCO SPIRIT DOCKED IN ST. JOHN'S HARBOUR BEFORE DEPARTING TO GATHER SEISMIC DATA.

Seismic exploration unlocks the secrets of Newfoundland and Labrador's offshore

IN SUMMER 2011, IN ANTICIPATION OF THE START OF SEISMIC EXPLORATION OF NEWFOUNDLAND AND LABRADOR'S OFFSHORE, THE SANCO SPIRIT SAILED INTO THE ST. JOHN'S HARBOUR. Over 2011 and 2012, the state-of-the-art seismic vessel will collect exploration data in the province's offshore that may play a significant role to future oil and gas development.

While Newfoundland and Labrador's offshore has more than 20 basins – and ones larger than those found offshore Norway – the province's basins are largely unexplored.

The licensing of data the Sanco Spirit will retrieve over its two-year program is one of the first steps in an exploration cycle, with a goal to increase exploration interest and development in the province's underexplored offshore.



LOWER CHURCHILL PROJECT

IN 2011, SEVERAL MILESTONES WERE ACHIEVED TOWARDS READINESS FOR THE PROJECT SANCTION DECISION FOR MUSKRAT FALLS. Progress was made in the areas of engineering, financing, Aboriginal and public consultation and environmental assessment.

Project execution advanced with the selection of SNC-Lavalin Inc. as the Project's engineering, procurement and construction management (EPCM) contractor for the Muskrat Falls Generating Facility and Labrador-Island Transmission Link.

Engineering on the marine cable crossing along the Strait of Belle Isle continued with a field program focused on horizontal directional drilling at Shoal Cove on the island of Newfoundland to identify design risks and mitigation measures. Field work also included a marine survey of the seabed across the Straits to gather information to help design appropriate protection for seabed cables.

In August 2011, the Government of Canada committed to a federal loan guarantee for the Muskrat Falls Project. The loan guarantee is an important economic investment in the province and will result in lower project costs through reduced interest rates. This, in turn, will lower electricity prices for consumers.

Nov. 18, 2011 marked an important event in the province's history. On that day, Nalcor participated in the signing ceremony for the New Dawn Agreement between Canada, the Province, and the Innu of Labrador. The agreement brings together three separate agreements related to land claims and self-government, Upper Churchill Redress, and Lower Churchill Innu impacts and benefits. The Labrador Innu's acceptance of these agreements mean benefits to the Innu of Labrador and represents a major step forward for the development of Muskrat Falls.

In August, the federal-provincial Joint Review Panel released their environmental assessment report on the proposed generation project, and in March 2012 both levels of government released the generation project from the environmental assessment process. Nalcor expects to file the Environmental Impact Statement for the Labrador-Island Link and associated transmission lines in 2012.

A principle of Nalcor's project development gateway process is the use of independent reviews leading to decision gates. The Muskrat Falls development underwent a review by Navigant Consulting in 2011 and Manitoba Hydro International (MHI) released its review in January 2012 as part of the province's Public Utilities Board review of the Muskrat Falls Project.

Navigant validated Nalcor's analysis of the Project as the least-cost alternative for meeting the province's future energy needs and concluded the Project also provides a gradual decrease in real (adjusted for inflation) average wholesale electricity rates for the island. MHI determined the Project was following best practices and concluded overall that the Interconnected Island is the least-cost option to meet the island's electricity needs. These reviews assist decision makers by validating Nalcor's work to date and identifying areas of potential improvement.

Further milestones to be achieved as Nalcor prepares for a project sanction recommendation include finalizing commercial arrangements and confirming project cost and schedule. The full economic and cumulative present worth analyses will also be updated. With this information Nalcor will make a recommendation to government on whether the Project should proceed to construction.

If sanctioned, after Muskrat Falls is constructed, and once export markets are secured, Nalcor will be in a position to proceed with the development of Gull Island, which may be used for industrial developments in the province as well as for export. Until that time, focus remains on developing Muskrat Falls to meet the province's energy needs.

NALCOR EMPLOYEES DISCUSS THE MUSKRAT FALLS PROJECT WITH THE PUBLIC AT LABRADOR EXPO IN HAPPY VALLEY-GOOSE BAY, NL.

Consultation is a priority for Nalcor

CONSULTATION WITH ABORIGINAL GROUPS AND THE GENERAL PUBLIC IS A PRIORITY FOR NALCOR. Throughout the year Nalcor held over 50 public and Aboriginal consultations, open houses, presentations and information sessions across the province. Some of these sessions related to ongoing environmental assessments for components of the Muskrat Falls development while supplier information sessions were held to prepare businesses for upcoming contract opportunities.

Nalcor is dedicated to ensuring Aboriginal groups, communities and businesses receive accurate, timely information and have the opportunity to provide comments about this important development.

BULL ARM FABRICATION

BULL ARM FABRICATION, ATLANTIC CANADA'S LARGEST INDUSTRIAL FABRICATION SITE SPREAD OVER 6,300 ACRES, IS LOCATED 140 KILOMETRES FROM NEWFOUNDLAND AND LABRADOR'S CAPITAL CITY OF ST. JOHN'S. Bull Arm is a world-class facility with capabilities for steel fabrication and concrete construction, outfitting installation, at-shore hook-up and deep water commissioning.

The Bull Arm facility is an important asset for industrial development in Newfoundland and Labrador and the advancement of the province's fabrication capacity. Major fabrication and industrial projects can be performed from start to finish at this one location with access to the worldwide marine transportation network through its deep water port.

Originally developed in the 1990s to construct the 600,000-tonne Gravity Base Structure (GBS) platform and topside components for the Hibernia Project, Bull Arm Fabrication has three fabrication sites allowing simultaneous operation in one location. The site is a natural venue to advance the construction of the province's next big offshore oil and gas project – Hebron.

In 2011, Nalcor continued preparations for the Hebron Project. The team worked diligently on sublease negotiations throughout the year and was committed to working closely with ExxonMobil Canada Properties (EMCP), the Hebron project operator, and ensuring a smooth transition of site operatorship. In the fall of 2011, EMCP and Nalcor Energy Bull Arm Fabrication signed a sublease agreement for occupancy from 2011 with an anticipated 2017 end date and early works preparations began in September 2011. This involved the preparation of the GBS/FPSO Quay to accommodate arrival of bulk carrier ships with bund wall material. They also worked on preparing the site which included dry dock preparation, establishment of temporary office trailers, transition of site utilities and general site readiness.

Leading up to the signing of the lease, Nalcor also completed renovations to the office building at the entrance to the Bull Arm site. This new office provides a base for Nalcor's site superintendent and a common meeting place for Nalcor and Hebron contractors on site. It will also act as the information center for the Hebron Project for visitors from industry and the community.

As part of its asset management framework, Nalcor will monitor site infrastructure modifications over the next few years such as additions, deletions, refurbishments and replacements proposed by the Hebron Project team, which include project operator EMCP, and its prime contractors Kiewit Kvaerner Contractors and Worley Parsons Ltd.

The Bull Arm team will also have ongoing communication with the Hebron Project team on safety and environmental programs and practices. Nalcor is focused on ensuring a successful leasing relationship with the tenants of Bull Arm and supporting the success of the Hebron Project. Nalcor's goal for Bull Arm is to establish a long-term, safe and competitive operation, with quality workmanship, and a sustained workforce which will provide significant benefits for the people of this province for years to come.

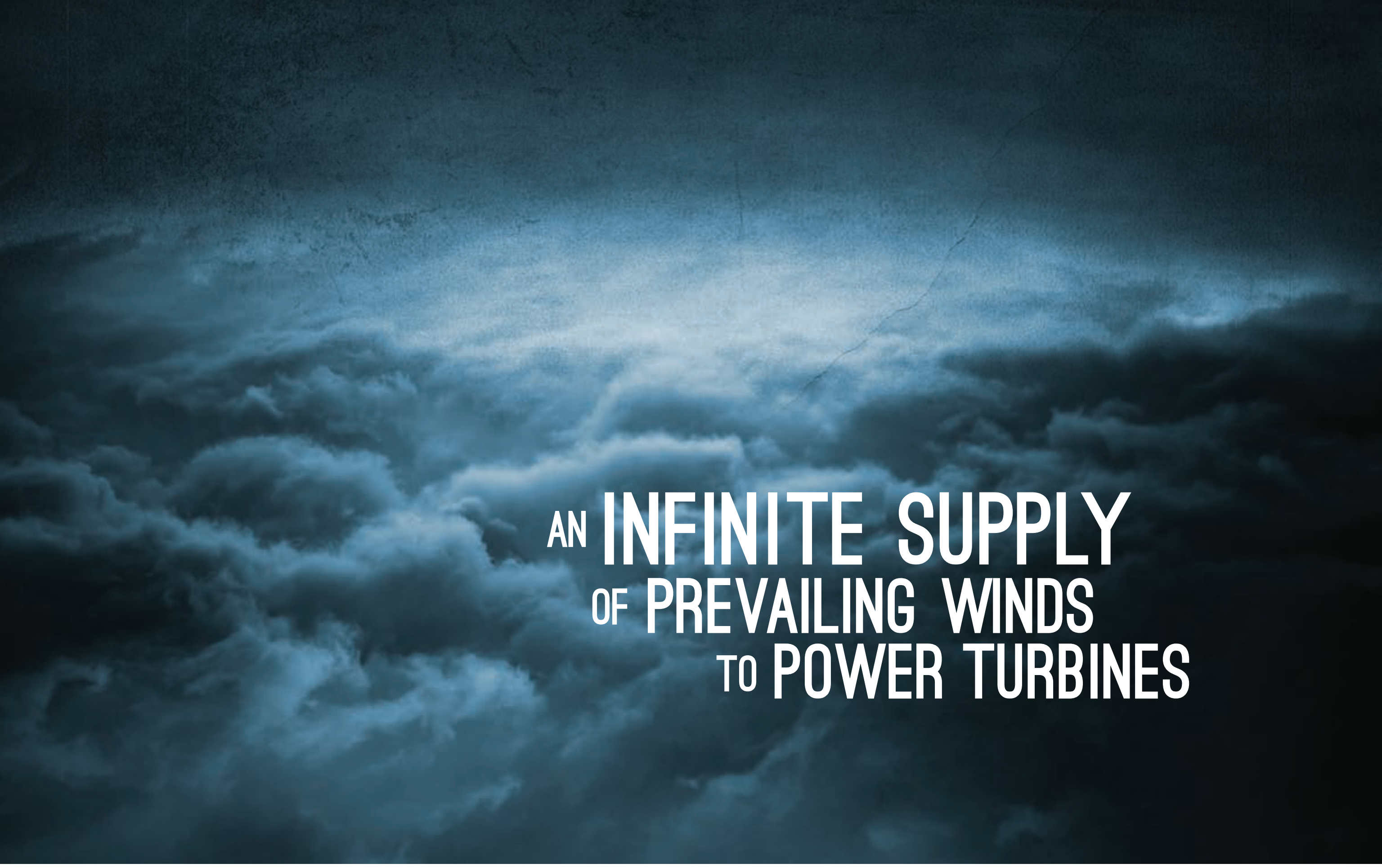
Nalcor will execute an engagement strategy over the next several years, incorporating input from key stakeholders which will facilitate the development of a long-term strategy for the site to ensure the success of Bull Arm Fabrication once Hebron exits the site.

BULL ARM EMPLOYEES AND LOCAL COMMUNITY MEMBERS COME TOGETHER FOR A BEACH CLEAN-UP.

Nalcor supports Bull Arm's neighbouring communities

NALCOR CONTINUED TO SUPPORT ITS NEIGHBOURING COMMUNITIES IN 2011 AND WAS PROUD TO CONTRIBUTE TO LOCAL EVENTS, SCHOOLS AND ORGANIZATIONS THROUGHOUT THE YEAR. The Bull Arm team volunteered at various initiatives such as judging a school science fair at Swift Current Academy, painting at Iris Kirby House, helping with the construction of the Town of Sunnyside's Fifty Plus Club's gazebo, and serving a healthy breakfast to students of Tricentia Academy with the Kids Eat Smart Foundation.

In August 2011, Bull Arm employees, the Town of Southern Harbour and members of the community showed their environmental commitment by collecting over 30 bags of garbage and loose debris during the second annual clean-up of Bottom Beach.



ENERGY MARKETING AND OTHER ENERGY ACTIVITIES

IN ADDITION TO NALCOR ENERGY'S FIVE LINES OF BUSINESS, THE COMPANY IS INVOLVED IN ENERGY MARKETING AND OTHER ENERGY ACTIVITIES, INCLUDING NON-REGULATED ELECTRICITY GENERATION, WIND ENERGY, AND RESEARCH AND DEVELOPMENT.

ENERGY MARKETING

The current portfolio managed by Nalcor's energy marketing team includes recall power not required by Hydro to meet demand in Labrador. In 2011, Nalcor continued its focus on maximizing the value of current assets, building reputation and expertise, and positioning Nalcor for its longer-term energy marketing needs.

Nalcor's energy portfolio will continue to grow over the coming years with the development of the Lower Churchill Project and increased production from Nalcor's offshore oil and gas interests. Nalcor's energy marketing capability will be a key enabler to maximize the overall value of its growing portfolio for its Shareholder and the pursuit of future opportunities.

EXPLOITS GENERATION

Nalcor is responsible for managing and operating the hydroelectric facilities on the Exploits River on behalf of the provincial government. Exploits Generation is focused on excellence in safety performance, environmental stewardship and operational performance of these assets.

In 2011, Exploits Generation made significant progress on completing elements identified in the 2010 environmental audit, meeting all targets set for the year. Employees also executed a successful capital program within the initial framework of a long-term asset management strategy.

Nalcor continued the highly successful Exploits River Salmon Management Program and the project's success story is well-known in the international scientific community. In

2011, a group from Finland including representatives from Finnish power company, Kemijoki Oy, a fish biologist and government agencies visited Exploits Generation to learn about successful fish passage efforts on the Exploits River. This program incorporates the longest known fish louvers in the world, which has a major impact on fish survival.

MENIHEK GENERATION

Nalcor's dedication to safety at its Menihek operation led to the successful implementation of Nalcor's corporate-wide Work Protection Code in 2011. Through a careful transition from the previous safety system at the Menihek generating station, operators are now fully trained in the corporate code.

Menihek completed all of its environmental initiatives for 2011 identified in the 2008 environmental audit. In addition, elements of the ISO 14001 Environmental Management System (EMS) identified in the gap closure plan were successfully completed.

The Menihek operation achieved electricity sales of 41.58 gigawatt hours (GWh) in 2011, exceeding sales guaranteed under contract, resulting in total net revenue generation of $1.4 million.

WIND-HYDROGEN-DIESEL ENERGY PROJECT

While the province has an abundance of renewable resources, many coastal isolated communities rely on electricity produced by diesel generating systems. To help reduce reliance on diesel generation, Nalcor built one of the first projects in the world to integrate generation from wind, hydrogen and diesel in an isolated electrical system. The Wind-Hydrogen-Diesel Energy Project in Ramea is a research and development project that uses renewable energy to supplement the diesel requirements of an electrically isolated island community.

Throughout 2011, Nalcor made considerable progress with the commissioning phase of the project, which will be complete in 2012. The EMS will automatically control and monitor the equipment, enabling the delivery of safe, efficient and reliable electricity to its utility customers. Following the commissioning phase, Nalcor will embark on the demonstration phase of the project which involves optimizing the operation of the facility, analyzing project data, increasing efficiencies of the equipment, and determining the market potential of the system.

EXPLOITS GENERATION EMPLOYEES COMPLETING CONFINED SPACE RESCUE TRAINING AT THE BISHOP'S FALLS GENERATING STATION.

Embracing safety culture at Exploits Generation

FOR THE SECOND YEAR IN A ROW, EMPLOYEES AT EXPLOITS GENERATION FINISHED THE YEAR WITHOUT ANY RECORDABLE SAFETY INCIDENTS OR INJURIES. Continuing their relentless commitment to safety, all Exploits Generation employees were also trained in Nalcor's Work Protection Code in 2011. The code helps create a safe work environment that eliminates or controls hazards.

Employees have taken a prudent, careful transition from their previous safety system into the corporate code to ensure a consistent and common approach in all Nalcor Energy companies. Employees are embracing the safety culture and recognizing the importance of a thoughtful approach to safety by taking their time and ensuring consistency on the job.

MANAGEMENT'S DISCUSSION & ANALYSIS

The following discussion and analysis is the responsibility of management and is as of March 23, 2012.

Nalcor Energy maintains appropriate systems of internal control, policies and procedures that provide management with reasonable assurance that assets are safeguarded and that its financial information is reliable. The Board of Directors carries out its responsibility for review of this disclosure principally through its Audit Committee, comprised exclusively of independent directors. The Audit Committee has reviewed and approved this Management's Discussion and Analysis (MD&A). This MD&A should be read in conjunction with the Consolidated Financial Statements of Nalcor Energy (Nalcor or the Corporation) for the years ended and included in this Business and Financial Report, as well as the notes, for the respective years.

Certain statements in this MD&A are forward-looking statements subject to risks and uncertainties. Statements containing words such as "could," "expect," "may" "anticipate," "believe," "intend," "estimate," "plan" and similar expressions constitute forward-looking statements. These statements are based on certain factors and assumptions, including: foreign exchange rates, expected growth, results of operations, performance and business prospects and opportunities. While Nalcor considers these factors and assumptions to be reasonable based on information currently available, they may prove to be incorrect. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to: fluctuations in supply and demand in electricity markets, changes in capital markets, changes in currency and exchange

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rates, unexpected environmental conditions, fluctuations in future fuel and electricity prices, changes in oil reserves and government or regulatory policy changes. Nalcor assumes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or any other reason.

SECTION 1: CORPORATE OVERVIEW AND STRATEGY

Nalcor Energy (Nalcor or the Corporation) is a Crown corporation established in 2007. Nalcor's business includes the development, generation, transmission and sale of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication site management; and energy marketing.

Nalcor's legal structure at December 31, 2011 included four wholly-owned subsidiaries: Newfoundland and Labrador Hydro (Hydro), Nalcor Energy – Oil and Gas Inc. (Oil and Gas), Nalcor Energy - Bull Arm Fabrication Inc. (Bull Arm Fabrication or Bull Arm) and Gull Island Power Corporation (GIPCo). Hydro holds investments in two entities: 65.8% of Churchill Falls (Labrador) Corporation (Churchill Falls) and 51% of Lower Churchill Development Corporation (LCDC). Churchill Falls holds a 33.3% investment in Twin Falls Power Corporation (Twin Falls).

Nalcor has segregated its business into five reporting segments. These reporting segments allow senior management to evaluate the operational performance and assess the overall contribution of each segment to Nalcor's long-term objectives. The following summary describes the operations included in each of the Corporation's reportable segments.

HYDRO REGULATED

Hydro Regulated is the regulated portion of Hydro that generates, transmits and distributes electricity to customers throughout Newfoundland and Labrador. Hydro Regulated ensures a safe, reliable and cost-effective electricity supply available to meet current demand and future growth. Hydro Regulated's operations consist of sales of electricity to three primary customer groups:

- Newfoundland Power, an investor-owned utility that distributes electricity to over 247,000 customers on the island portion of the province, with Hydro Regulated supplying 93% (2010 – 93%) of its energy requirements comprising 78.6% of regulated revenue (2010 – 76.8%).
- Over 36,000 residential and commercial customers in rural Newfoundland and Labrador comprising 13.6% of regulated revenue (2010 – 14.4%).
- Major industrial customers primarily in the pulp and paper, mining and oil refining industries comprising 3.7% of regulated revenue (2010 - 4.5%).

Hydro Regulated is regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB). Rates are set through periodic general rate applications using a cost of service (COS) methodology whereby Hydro Regulated is entitled to recover, through customer rates, all reasonable and prudent costs incurred in providing electricity service to its customers including a return on rate base.

In 2009, the Province of Newfoundland and Labrador (the Province) issued an Order in Council which provided Hydro Regulated with the ability to earn a rate of return equal to the rate approved by the PUB for Newfoundland Power, effective following the next general rate application. Currently, Hydro Regulated earns a return on rate base equal to 4.47% for the purpose of determining its cost of capital. This level of return is based on a previous PUB decision which established the return on equity (ROE) at a rate equal to the long-term marginal cost of debt. The ability to earn a comparable ROE to Newfoundland Power and most regulated utilities across Canada provides a foundation for improved future financial performance.

Hydro Regulated's generating assets, with a total capacity of 1,637 megawatts (MW), consist of nine hydroelectric plants (939 MW), one oil-fired plant (490 MW), four gas turbines (142 MW), 25 diesel plants (55.4 MW) and 0.3 MW of wind. In addition, Hydro Regulated has entered into a number of power purchase agreements with non-utility generators to supplement its generation capacity.

Hydro Regulated's business strategy is to manage its assets in a manner that optimizes total cost of operation and maintenance while delivering safe, reliable service. Nalcor has implemented a corporate-wide asset management framework and organizational design which facilitates this strategy.

CHURCHILL FALLS

The Churchill Falls Generating Station is one of the largest underground powerhouses in the world with a rated capacity of 5,428 MW. A power contract with Hydro-Quebec dated May 12, 1969 (the Power Contract) provides for the sale of the majority of the electricity from this facility [approximately 30 terawatt hours (TWh)] until 2041.

Churchill Falls sells 300 MW annually, the maximum provided for under the Power Contract, to Hydro for use in Labrador and export sales (recall energy). Churchill Falls also sells 225 MW (approximately 1.8 TWh) to Twin Falls to service the mining industry in Labrador West. In addition, Churchill Falls earns revenue from Hydro-Quebec under a Guaranteed Winter Availability Contract (GWAC). GWAC was signed with Hydro-Quebec in 1998 and provides additional revenue for the sale of up to 682 MW of seasonal availability to Hydro-Quebec during the months of November through March until the end of the Power Contract in 2041.

The strategy for Churchill Falls focuses on safely operating and maintaining its assets to optimize long-term value while meeting all contractual obligations. Nalcor, through its subsidiary, Hydro, holds a 65.8% interest in Churchill Falls, with Hydro-Quebec holding the remainder. In 1999, as a result of the Shareholders' Agreement between Hydro, Hydro-Quebec and Churchill Falls (Labrador) Corporation, Hydro commenced accounting for its investment in Churchill Falls as a joint venture (see Note 2 to the Consolidated

Financial Statements) and includes 65.8% of the revenues, expenses, assets and liabilities of Churchill Falls in the consolidated accounts.

OIL AND GAS

Oil and Gas is a partner in three developments in the Newfoundland and Labrador offshore – the Hebron oil field, the province's fourth offshore oil project which is currently in the pre-development stage; the White Rose Growth Project, which produced first oil from the North Amethyst field in May 2010; and the Hibernia Southern Extension Unit, which produced first oil in June 2011.

Oil and Gas has also undertaken activities to advance exploration activities onshore in the province. Oil and Gas acquired a working interest averaging approximately 67% in three exploration permits in the Parsons Pond area on the Great Northern Peninsula. Oil and Gas drilled two wells on these permits and based on data gathered from these wells, a planned third well was not pursued. This drilling program obtained an extensive data set and insights that will guide future exploration activities in the area.

Oil and Gas has developed a multi-year exploration strategy that outlines priorities for data acquisition. Oil and Gas' strategy in acquiring high quality data is to encourage more exploratory drilling in keeping with this strategy. Oil and Gas has also entered into a strategic partnership in a seismic survey of offshore Newfoundland and Labrador. Nearly 11,000 km of high-quality seismic data was acquired in 2011. This is the first stage in a multi-year program that will significantly add to the offshore 2D seismic data set.

ENERGY MARKETING

The revenue and earnings in this segment are derived primarily from electricity sales from the portion of the 300 MW recall energy not required to meet electricity needs in Labrador. Nalcor has a firm booking for 265 MW of long-term electricity transmission capacity from Hydro-Quebec from Labrador through Quebec to the Canada-United States border. Under this arrangement, electricity is sold on the Canadian side of the border to a third-party energy marketer. Nalcor also has arrangements to sell electricity directly to utilities elsewhere in Canada.

LOWER CHURCHILL PROJECT, BULL ARM FABRICATION AND OTHER

This business segment includes the Lower Churchill Project. The two sites on the lower Churchill River are the most attractive undeveloped hydroelectric projects remaining in North America and are a key component of the province's energy warehouse. The Project's two proposed installations at Muskrat Falls and Gull Island will have a combined capacity of over 3,000 megawatts (MW).

The Bull Arm Fabrication site, Atlantic Canada's largest industrial fabrication site, is also included. This facility spans over 2,560 hectares and has an integrated and comprehensive infrastructure to support fabrication and assembly.

Also included in this business segment are certain non-regulated activities including sales to industrial customers in Labrador, the operations of the Menihek Generating Station as well as business development and corporate activities.

SECTION 2: PERFORMANCE

FINANCIAL HIGHLIGHTS

This section provides an overview of Nalcor's financial performance based on its audited Consolidated Financial Statements.

millions of dollars	2011	2010
Revenue	$ 729.9	$ 620.1
Expenses	603.2	542.6
Net income	$ 126.7	$ 77.5
Key Financial Performance Indicators:		
Cash flow from Operations	$ 212.7	$ 146.4
Return on Equity	9.4%	6.4%
Total debt to capital	38.5%	42.5%
Return on Capital Employed	10.9%	8.7%

Cash flow from operations – Cash Flow from Operations before Working Capital Adjustments

Return on equity (ROE) – Net Income/Average Equity

Debt to capital – Total debt (promissory notes, long-term debt including current portion less sinking funds), divided by debt plus shareholders' equity.

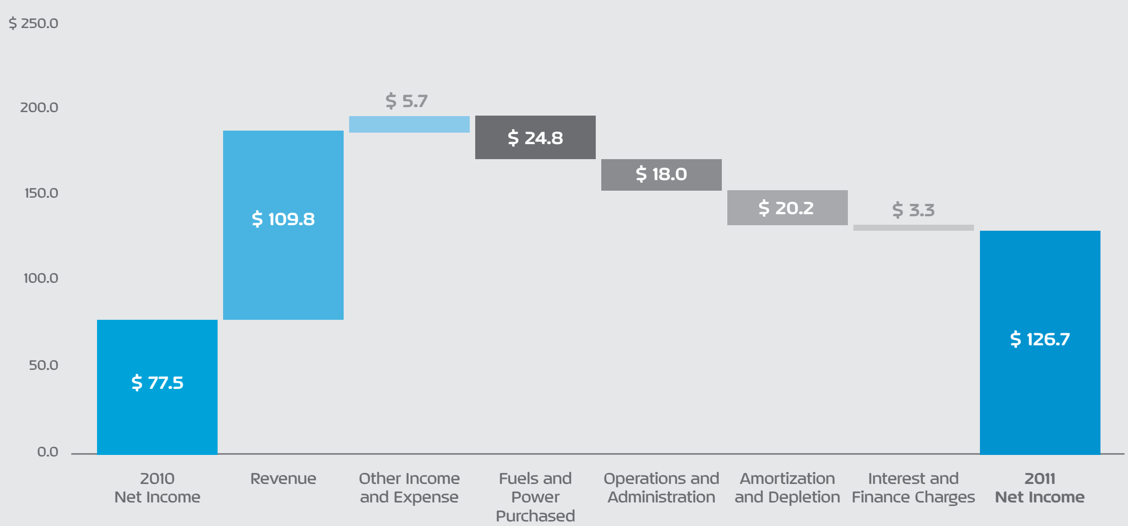
Return on Capital Employed (ROCE) – Net Income plus Interest/Average Debt plus Equity (adjusted for assets under development)

Certain comparative figures have been reclassified to comply with the current year's presentation

Overall net income for 2011 was $126.7 million, an increase of $49.2 million from the $77.5 million reported for 2010. The primary reasons for the increase in net income were an increase in Oil and Gas earnings of $41.6 million and an increase in earnings from the Hydro Regulated segment of $14.5 million. These increases were offset by a reduction in earnings from Energy Marketing and Churchill Falls of $5.6 million and $2.4 million respectively. Variances by major category are outlined below and discussed in more detail in the Business Segment Review.

- **Revenue**: Revenue was $729.9 million, an increase of $109.8 million in 2011 compared to 2010 revenue of $620.1 million, primarily due to increased Oil and Gas production resulting in increased sales.
- **Other income and expense**: Other income and expense includes $3.9 million in expenses from electricity price swaps and foreign exchange forward contracts (2010 - $2.6 million) as well as net gains on disposal of assets of $2.7 million (2010 - $0.7 million) and insurance proceeds of $3.6 million (2010 – nil).
- **Fuels**: Fuel expense was $156.7 million, an increase of $16.3 million in 2011 compared to $140.4 million in 2010, primarily due to fuel price adjustments resulting from the Rate Stabilization Plan (RSP).

NALCOR ENERGY - NET INCOME COMPARISON 2011 VS. 2010 | $ MILLIONS



- **Power purchased**: Power purchased costs were $52.9 million, an increase of $8.5 million in 2011 over 2010 costs of $44.4 million, primarily due to a power purchase agreement with the Province for the output from the hydroelectric assets on the Exploits River.
- **Operations and administration**: Operations and administration costs were $199.9 million, an increase of $18.0 million over 2010 costs of $181.9 million primarily due to salaries and related benefit costs of $8.0 million, bad debt expenses of $4.0 million, consulting costs mainly related to various PUB filings of $1.1 million and Oil and Gas production costs of $5.8 million.
- **Amortization and depletion**: Amortization and depletion was $87.7 million, an increase of $20.2 million over 2010 of $67.5 million. The increase was primarily the result of higher depletion expense of $18.7 million in Oil and Gas commensurate with an increase in production levels. Amortization expense also increased due to increasing levels of property, plant and equipment and marginally higher amortization levels each year as a result of the sinking fund method of amortization in Hydro Regulated.
- **Interest and finance charges**: Interest was $108.4 million, an increase of $3.3 million compared to $105.1 million in 2010. This increase is primarily related to additional interest expense due to the balance in the RSP and reinstatement of a debt guarantee fee to the Province.
- **Capital expenditures**: Capital expenditures were $254.6 million, an increase of $58.3 million over 2010 levels as depicted below:

millions of dollars	2011	2010
Hydro Regulated	$ 63.1	$ 55.5
Churchill Falls	25.6	9.9
Oil and Gas	63.3	82.8
Lower Churchill Project, Bull Arm, Other	102.6	48.1
	$ 254.6	$ 196.3

The primary reason for the increased expenditures relates to the increased capital program in Churchill Falls and expenditures related to the Lower Churchill Project.

Cash flow from operations for 2011 was $212.7 million, an increase of $66.3 million primarily due to increased cash generated from Oil and Gas activities. ROE improved due to the increase in earnings compared to a slight increase in equity. Nalcor's percentage of equity improved due to strong earnings and equity injections from the Province. Return on capital employed (ROCE) improved largely due to the impact of increased earnings on an average capital employed base that increased marginally from the previous year.

BUSINESS SEGMENT REVIEW

In 2011, Nalcor reported its financial results in five business segments: Hydro Regulated, Churchill Falls, Energy Marketing, Oil and Gas, and Lower Churchill Project, Bull Arm Fabrication and Other. These business segments include the five lines of business of Nalcor and are differentiated on the basis of regulatory status and management accountability.

The 2011 financial results by business segment are shown in the following table:

millions of dollars	2011	2010
Hydro Regulated	$ 21.0	$ 6.5
Churchill Falls	24.4	26.8
Oil and Gas	39.1	(2.5)
Energy Marketing	43.3	48.9
Lower Churchill Project, Bull Arm, Other	(1.1)	(2.2)
Total	$ 126.7	$ 77.5

HYDRO REGULATED

The operations of Hydro Regulated are influenced by many external factors; including the domestic economy, weather patterns and fuel costs. During 2011, colder winter weather and increased load growth resulted in increased demand for electricity.

The demand for electricity is met through a combination of hydroelectric generation, thermal generation and power purchases including wind generation. Hydro Regulated uses the RSP both as a means to smooth rate impacts for island electricity consumers and to protect Hydro Regulated's net income from variations in the Holyrood Thermal Generating Station fuel costs. Fuel costs fluctuate as a result of variations in energy sales, fuel prices and hydraulic production from the levels that were in effect when base rates were last set in 2007. Resulting variations deferred in the RSP are recovered from or refunded to, electricity consumers in the following year, with the exception of the hydraulic variation, which is recovered or refunded at a rate of 25% annually.

Net income for 2011 was $21.0 million, an increase of $14.5 million over the 2010 net income of $6.5 million. The factors affecting the 2011 increased earnings are depicted in the chart at the bottom of this page:

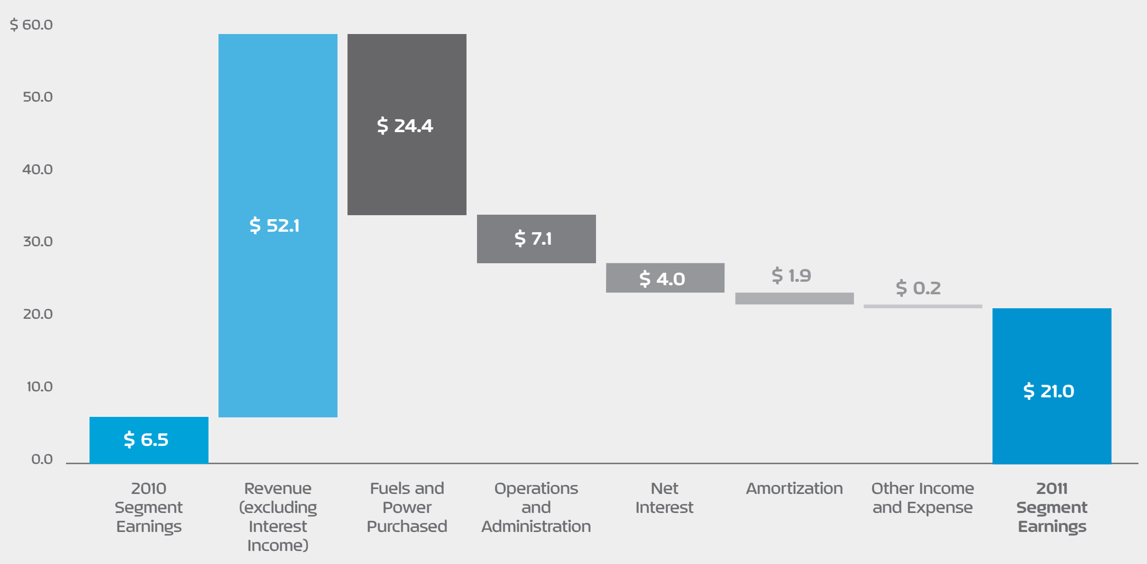
Revenue by major customer category is outlined below:

millions of dollars	2011	2010
Newfoundland Power	$ 384.6	$ 334.6
Rural customers	66.7	62.7
Industrial customers	17.9	19.8
Interest, finance and other income	19.9	18.4
Total revenue	$ 489.1	$ 435.5

Total revenue from Newfoundland Power increased overall by $50.0 million due to increased sales and an increase in RSP recovery. Electricity sales to Newfoundland Power increased by 301 gigawatt hours (GWh), mainly as a result of colder weather and generally increased load growth resulting in an increase in revenue of $27.4 million. In addition, there was $22.6 million more revenue recovered from customers through the RSP due to the increase in sales and RSP rate differences.

Revenue from Hydro Regulated's rural customers increased by $4.0 million due to increased load of 65 GWh. Rates

HYDRO REGULATED - 2011 VS. 2010 SEGMENT EARNINGS | $ MILLIONS



for rural customers are adjusted annually on July 1 as a result of the operation of Newfoundland Power's Rate Stabilization Adjustment.

Sales to industrial customers decreased by 59 GWh. This reduction in energy requirement resulted in a $1.9 million reduction in revenue after RSP adjustments. On the island, sales to the pulp and paper industrial sector were down due to higher electricity generation from customer's own sources and lower overall electricity requirements. Secondary sales to CFB Goose Bay were consistent with 2010 levels of $4.0 million.

The hydraulic variation that has accumulated in the RSP has been positive in recent years and results from higher than average hydroelectric production, enabled by lower reservoir storage requirement for drought protection due to reduced loads. This higher hydraulic production has reduced the need for thermal generation and related fuel costs.

The balance in the RSP is also increasing due to reduced loads from industrial customers and variations in the fuel rider rates for Newfoundland Power. The increased balance results in higher interest costs, as interest is accrued on the outstanding balance based on the weighted average cost of capital of 7.6%. Rates are also adjusted annually based on forecast fuel prices through a fuel rider. The fuel rider and rate adjustment for the accumulated RSP balances becomes effective annually on July 1 for Newfoundland Power and RSP rates for industrial customers are set on January 1 of each year.

The RSP balance due to customers as at December 31, 2011 was $170.3 million (2010 - $159.2 million). A portion of the RSP balance totalling approximately $100 million, accumulated since 2007, has been set aside by the PUB to be allocated among the industrial customers and retail customers. This balance is mainly due to reduced use of the Holyrood Thermal Generating Station leading to fuel savings as a result of the shut down of a portion of the pulp and paper industry in the province since 2007.

Hydro Regulated utilizes No. 6 fuel oil at the 490 MW Holyrood Thermal Generating Station and diesel fuel at its diesel plants. The following table summarizes fuel consumed at the Holyrood Thermal Generating Station and the average price per barrel.

millions of dollars	**2011**	2010
No. 6 fuel		
Consumption (millions of barrels)	**1.5**	1.4
Average price (CAD 4 BBL)	**$ 91.9**	$ 73.9

Fuel expense includes the cost of No. 6 fuel, diesel fuel and adjustments to the fuel cost resulting from the operation of the RSP. Fuel costs are summarized below:

millions of dollars	2011	2010
No. 6 fuel/RSP/other	$ 140.7	$ 128.1
Diesel	16.0	12.2
Total fuel expense	$ 156.7	$ 140.3

No. 6 fuel/RSP/other costs increased by $12.6 million. Consumption of fuel at the Holyrood Thermal Generating Station increased by 108,000 BBLs which, when combined with fuel price increases, resulted in increased costs for No. 6 fuel of $34.4 million over 2010. This increase was offset by the application of the RSP components that are designed to smooth such increases for rate payers. These adjustments decreased fuel expense by $44.2 million in 2011 over 2010. In addition, the administration of the RSP requires the recognition of adjustments made in prior years and accordingly additional fuel costs of $23.1 million over 2010 levels were incurred. Other miscellaneous decreases of $0.7 million were also experienced.

To supplement Hydro Regulated's electricity generation on the island, Hydro Regulated purchases power under long-term agreements with non-utility generators (see Note 20(f) to the Consolidated Financial Statements). During 2011, Hydro Regulated also entered into a power purchase arrangement with the Province for the output from the hydroelectric assets on the Exploits River. In Labrador, on the interconnected grid, Hydro Regulated purchases substantially all of its energy requirements from Churchill Falls.

Total power purchased increased by $8.0 million from $44.2 million in 2010 to $52.2 million in 2011. This increase is primarily due to the additional power purchased from the Province from the Exploits assets.

Hydro Regulated's net interest expense increased by $4.0 million from $86.8 million in 2010 to $90.8 million in 2011. The increase is primarily related to reinstatement of a revised debt guarantee fee payable to the Province. The guarantee fee is based on a range of 0.25% to 0.50% of the total debt outstanding (net of sinking funds) guaranteed by the Province, as at the preceding December 31. In 2010 this fee was waived; however, in 2011, Hydro Regulated was required to pay a fee of $3.9 million.

Hydro Regulated's 2011 operating costs comprised 52% (2010 - 53%) of consolidated operating costs as outlined below:

millions of dollars	2011	2010
Salaries	$ 67.8	$ 63.1
Maintenance	21.5	21.7
Other	14.9	12.3
Total	$ 104.2	$ 97.1

Total operating costs increased by $7.1 million over the 2010 level. Salaries and benefits increased by $4.7 million primarily due to negotiated union wage settlements, normal cost of living adjustment increases and increases associated with employee future benefits. Other costs increased by

$2.6 million due to costs associated with preparation of various PUB filings and increases in other professional fees.

Hydro Regulated's amortization expense was $45.7 million, an increase of $1.9 million over 2010, primarily due to amortization expense related to asset retirement obligations recognized, increasing levels of property, plant and equipment and marginally higher amortization levels each year as a result of using the sinking fund method of amortization.

Hydro Regulated made $63.1 million in capital investments and upgrades in 2011 (2010 - $55.5 million) to ensure continued reliability of the electricity system. Investments were made in the following categories:

millions of dollars	2011	2010
Generation	$ 13.2	$ 16.2
Distribution	25.7	17.8
Transmission	15.5	11.0
Other	8.7	10.5
	$ 63.1	$ 55.5

Hydro Regulated maintains a capital structure comprised of 75% debt and 25% equity.

In addition to the asset retirement obligations related to retirement of portions of the Holyrood Thermal Generating Station recognized in 2010, Hydro Regulated also recognized obligations related to the disposal of polychlorinated biphenyls (PCBs) in 2011.

MANAGEMENT'S DISCUSSION & ANALYSIS

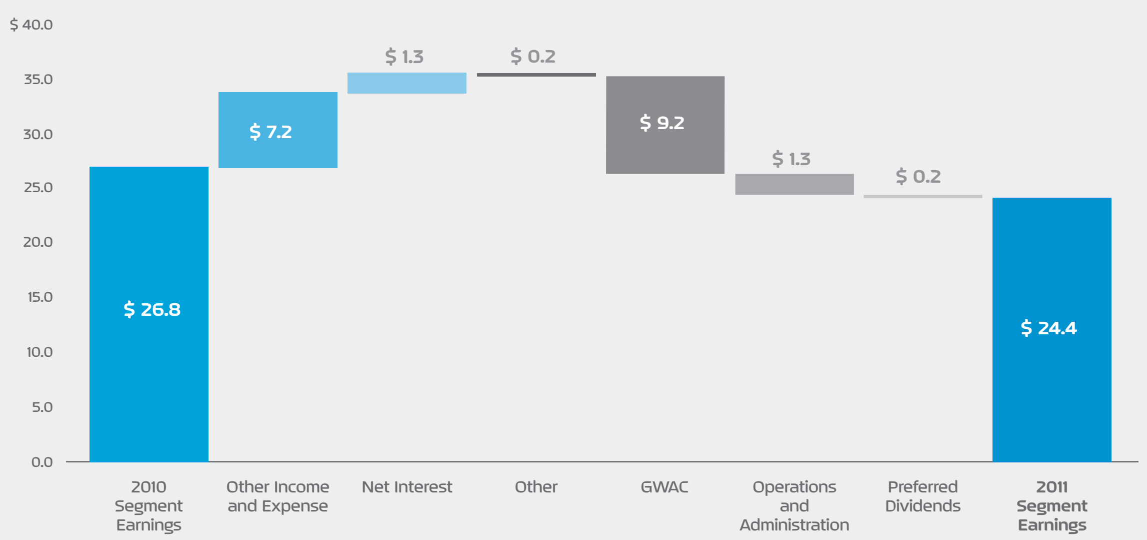
PERFORMANCE

CHURCHILL FALLS

In 2011, Churchill Falls segment earnings were $24.4 million, a decrease of $2.4 million compared to 2010. The factors affecting the 2011 decreased earnings are depicted in the following chart:

Churchill Falls' capital requirements are expected to increase to ensure necessary betterments and replacements are made to aging infrastructure at the plant. Churchill Falls has established a long-term asset management plan which addresses capital requirements until the end of the Power

CHURCHILL FALLS - 2011 VS. 2010 SEGMENT EARNINGS | $ MILLIONS



The decrease in net income was mainly due to loss of GWAC revenue of $9.2 million which was partially offset by net proceeds from two insurable losses experienced during the year of $7.2 million. With respect to the insurable losses noted, the first related to damage to a transformer for which Churchill Falls received insurance proceeds of $4.4 million. The second related to damage to a generating unit that occurred during a planned inspection conducted by a third party contractor. This resulted in the unit being down from August to December and resulted in significant lost GWAC revenue. Total estimated insurance proceeds related to this incident were $5.2 million of which $3.6 million related to business interruption insurance. Repairs to the unit are ongoing and it is expected to return to service in the second quarter of 2012.

Contract in 2041. Accordingly, during 2011, Churchill Falls invested $38.9 million (2010 - $15.1 million). In accordance with the 1999 Shareholders Agreement, Churchill Falls created a segregated fund to contribute towards funding capital expenditures related to the replacement of existing infrastructure. As at December 31, 2011, this fund had a balance of $69.0 million (2010 - $59.7 million).

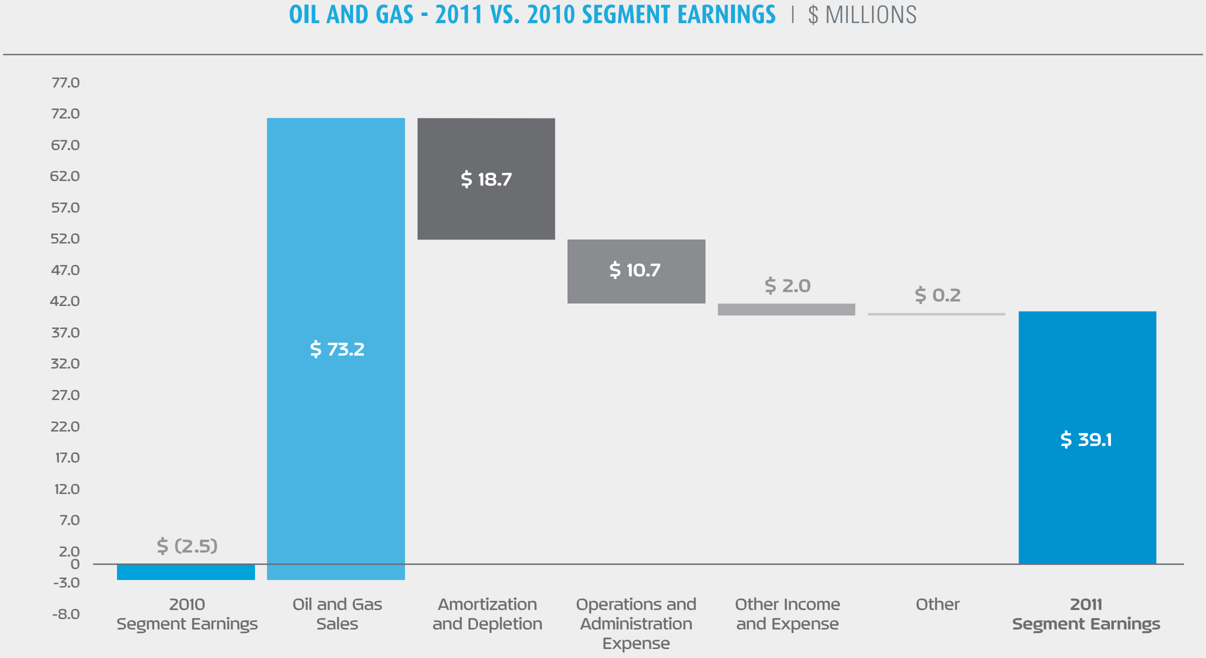
On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time. On February 3, 2010, the Government established the Churchill Falls

(Labrador) Corporation Trust (Trust) with Churchill Falls as the beneficiary. The purpose of the Trust is to fund the external costs incurred as a result of the motion filed by Churchill Falls and to date, $1.5 million in costs have been incurred in relation to this matter.

In 2011 Churchill Falls recognized asset retirement obligations related to the disposal of PCBs in the amount of $0.6 million.

OIL AND GAS

Total production in 2011 was 798,000 barrels of oil and total sales were $88.5 million compared to 185,000 barrels of oil and $15.3 million in 2010. The average price per barrel realized in 2011 was $113 USD as compared to $84 USD in 2010. During 2011, Oil and Gas had first oil from two fields; West White Rose, which is part of the White Rose Growth Lands, and Hibernia Southern Extension. Net income for 2011 was $39.1 million, an increase of $41.6 million from the loss of $2.5 million in 2010. The primary reasons for this are an increase in production levels and strong crude oil prices. Details are depicted in the following chart:



During 2011, costs capitalized as petroleum and natural gas properties totalled $63.2 million (2010 - $82.7 million) and include, in addition to direct acquisition costs, pre-development, development and drilling costs, legal fees, environmental consulting and project management. The $63.2 million consisted of expenditures related to the White Rose Growth Lands of $16.7 million, Hebron of $18.8 million, Hibernia Southern Extension of $22.2 million and Parsons Pond of $5.5 million.

Oil and Gas reserves

Nalcor contracted independent qualified reserve evaluators to evaluate and prepare reports on Oil and Gas' oil reserves according to the Canadian Oil and Gas Evaluation Handbook reserve definitions and standards.

Reserves as at December 31, 2011:

	Light and Medium Oil	
thousands of barrels	Gross	Net
Developed	1,985	1,832
Undeveloped	6,731	5,354
Total Proved	8,716	7,186
Probable	43,984	32,332
Total Proved Plus Probable	52,700	39,518

Total Gross Proved and Probable reserves at December 31, 2011 are 52,700 mbbls, an increase of 29,988 mbbls over 2010 reserve levels. This increase is mainly a result of field additions, extensions and infill drilling.

Depletion, Depreciation and Amortization (DD&A)

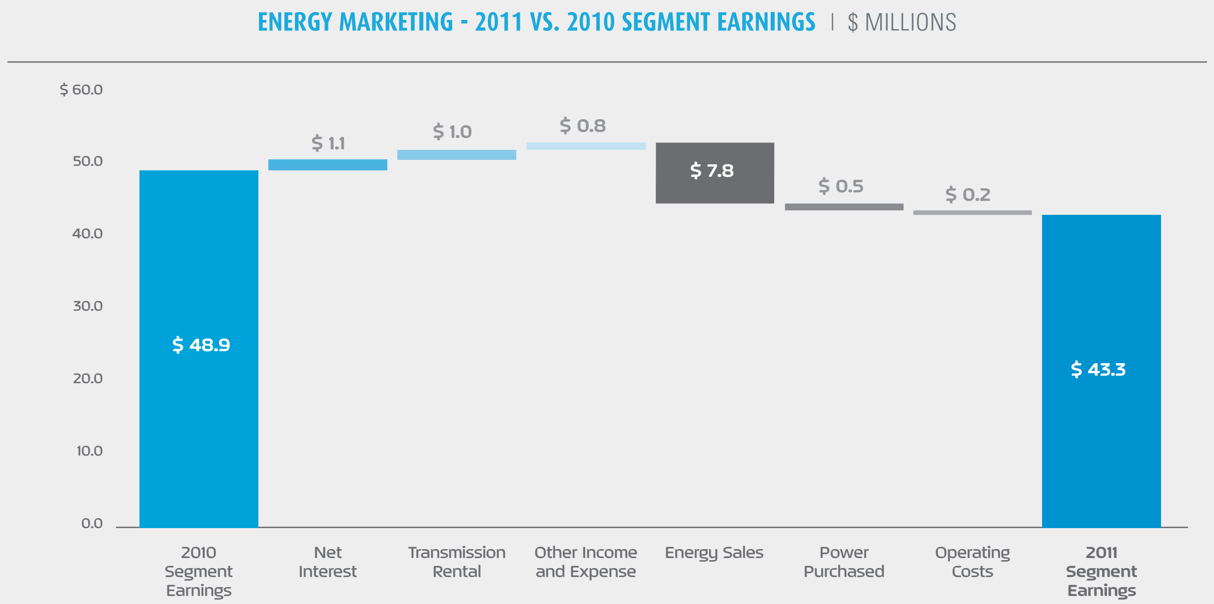
Under the full cost method of accounting for oil and gas activities, DD&A is calculated on a country-by-country basis. The DD&A rate is calculated by dividing the capital costs subject to DD&A by the proved oil and gas reserves expressed as equivalent barrels (boe). The resultant dollar per boe is assigned to each boe of production to determine the DD&A expense for the period. In 2011, DD&A expense related to oil and gas properties was $29.2 million (2010 - $10.6 million). The increase is mainly due to an increase in production levels.

The full cost method of accounting requires the costs of unproved properties and major development projects to be excluded from the DD&A calculation. At December 31, 2011, capital costs related to the Hebron project of $139.1 million (compared with $139.3 million at the end of 2010) were excluded from the DD&A calculation. Unproved properties are excluded from the calculation until the properties are evaluated and proved reserves are attributed to the project or the project is deemed to be impaired. At the end of 2011, $25.2 million of costs related to Oil and Gas' onshore exploration permits at Parsons Pond were added to the depletion base (2010 - nil).

In addition to the asset retirement obligations related to the White Rose Growth Lands recognized in 2010, Oil and Gas recognized additional obligations in the amount of $0.9 million in 2011 related to the Hibernia Southern Extension.

ENERGY MARKETING

In 2011, Energy Marketing sales of 1.5 TWh at an average realized price of $45 USD per MW resulted in $69.7 million in revenue compared to $77.5 million from 1.4 TWh at $50 USD per MWh in 2010. Segment earnings were $43.3 million, a decrease of $5.6 million from 2010. The primary reason for this decrease was lower market electricity prices in the US and the expiration of a series of favorably priced foreign exchange hedges put in place in 2009. Details of the year over year change in Energy Marketing earnings are noted in the following chart:



A combination of fixed price contracts, spot and day-ahead sales provides Nalcor with a diversified sales portfolio. Nalcor's energy marketing performance is evaluated based on benchmark pricing at an interface in the New York Independent System Operator (NYISO) which corresponds to the delivery point of Nalcor's firm annual transmission booking. In 2011, Nalcor's net revenue from Energy Marketing activities exceeded the NYISO pricing benchmark by 18% (2010 – 33%).

Costs associated with the transmission booking through Quebec decreased by $1.0 million due to a decrease in regulated transmission rates in Quebec.

Energy Marketing revenues are denominated primarily in US dollars (USD) and in 2009 Nalcor entered into a series of forward foreign exchange contracts, expiring in April 2011, to mitigate the impact of currency fluctuations on earnings. These forward contracts were accounted for as hedges and revenue for 2011 includes $1.5 million (2010 - $5.9 million) in gains resulting from the qualifying hedges. In 2011, Nalcor entered into a series of additional forward foreign exchange contracts as well as commodity swap contracts to minimize the impact of fluctuations in electricity prices. In 2011, Other income and expense includes $1.8 million of expenses resulting from these contracts a decrease of $0.8 million from 2010.

LOWER CHURCHILL PROJECT, BULL ARM FABRICATION AND OTHER

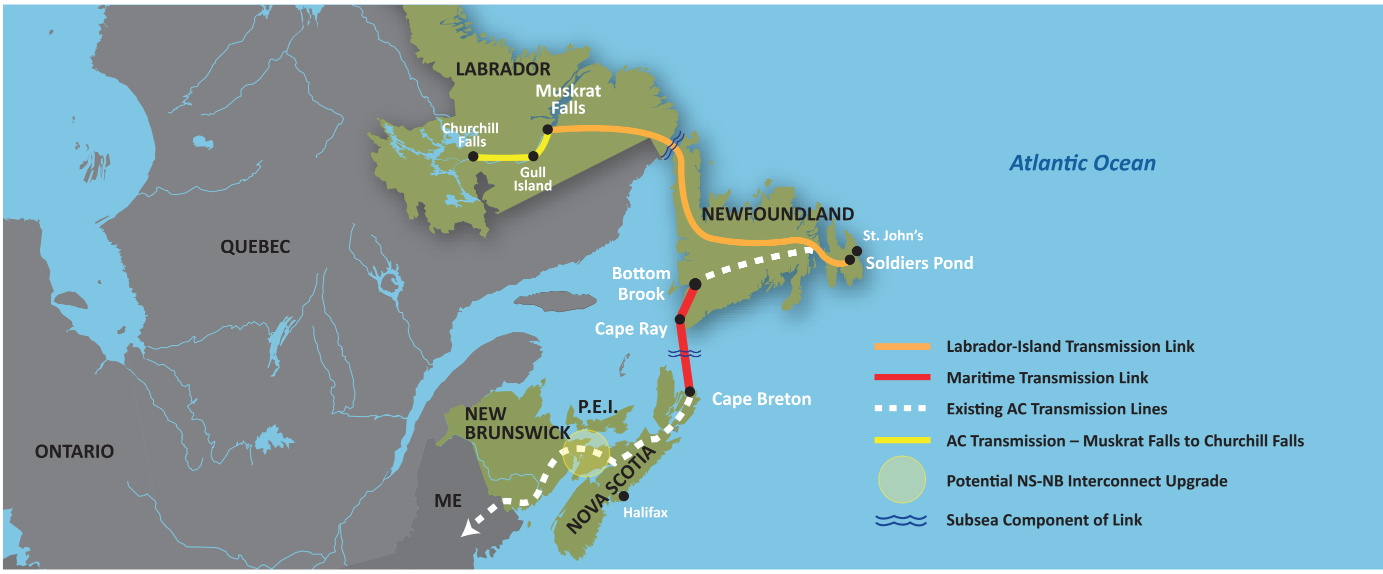
Lower Churchill Project: In 2011, Nalcor incurred $96.7 million in costs associated with the development of the Lower Churchill Project (2010 - $43.7 million) resulting in a cumulative investment of $329.0 million. Phase One includes Muskrat Falls, an 824 MW hydroelectric development on the lower Churchill River in Labrador; a new transmission line (the Labrador-Island Transmission Link) to be constructed from Labrador across the Strait of Belle Isle to the Avalon Peninsula on the island of Newfoundland; and a new transmission system (the Maritime Transmission Link) from Newfoundland to Nova Scotia.

The 824 MW Muskrat Falls generation facility and the transmission link from Labrador to the island of Newfoundland has been identified by Nalcor as the least-cost, long-term option for meeting the province's growing electricity demand. Nalcor would use production from the Muskrat Falls generating facility to displace oil-fired generation from the Holyrood Thermal Generating Station, meeting growing demand and providing long-term rate stability. Power would also be available for industrial development in the province.

Nalcor has entered into a term sheet with Nova Scotia's Emera Inc. Emera will construct the Maritime Transmission Link between the island of Newfoundland and Nova Scotia. Nova Scotia will receive 20% of Muskrat Falls' power over the 35-year period. At the end of 35 years, ownership of the Maritime Link will revert to Nalcor. Nalcor can use the link to transmit any surplus power from Muskrat Falls, as well as energy from any new generation sources developed in Newfoundland and Labrador. The link will also allow imports of power facilitating increased reliability for consumers.

Several important milestones were achieved in 2011. In August, the Government of Canada committed to a federal loan guarantee for the Muskrat Falls Project. The loan guarantee would result in lower project costs through reduced interest rates meaning lower electricity prices for consumers. Throughout 2011, Nalcor and Emera continued finalizing commercial agreements.

In November 2011, Nalcor, the Government of Newfoundland and Labrador, the Innu Nation and Innu Band Councils signed the Lower Churchill Impacts and Benefits Agreement and the Upper Churchill Redress Agreement (UCRA). The signing of these agreements provides benefits to the Innu and represents a key step in the development of the Lower Churchill Project.



Two independent reviews of the Muskrat Falls Project were undertaken in 2011. In its report released in September, Navigant Consulting validated Nalcor's analysis of the Project as the least-cost alternative for meeting the province's future energy needs. As part of a review conducted by the PUB, Manitoba Hydro International, in a report released in early 2012 determined the Project was following best practices, highlighted some perceived gaps that Nalcor is reviewing, and concluded overall that the Interconnected Island option is the least-cost option to meet the island's electricity needs.

In August 2011, the federal-provincial Joint Review Panel released their environmental assessment report on the generation project, and in March 2012 the federal and provincial governments released the generation project from the environmental assessment process. Nalcor intends to file the Environmental Impact Statement for the Labrador-Island Transmission Link and associated transmission lines in 2012.

In 2011, Nalcor continued its efforts to obtain transmission via the Hydro-Quebec Transmission system for the Lower Churchill Project. Proceedings before the Regie were concluded on the complaints filed by Hydro regarding Hydro-Quebec's treatment of Hydro's 2006 transmission service request and the application of the open access transmission rules in a manner that Hydro considered unfair. In June 2010, Hydro filed an application for revision of the Regie's May 2010 decision on the complaints. In April 2011, the Regie upheld its initial decisions to deny the complaints. In May 2011, Hydro filed an application with the Superior Court of Quebec for a judicial review of the Regie decisions. A hearing is scheduled for January 2013. Nalcor will continue to assess all options to advance market access for Gull Island.

Bull Arm Fabrication: The Bull Arm Fabrication site is an important asset in the development of the oil and gas industry in Newfoundland and Labrador. The site has facilitated the advancement of the province's fabrication capability through major projects including Hibernia, Terra Nova and White Rose oil projects. The Bull Arm site was originally developed in the 1990s to construct the 600,000-tonne Gravity Base Structure (GBS) platform and topside components for the Hibernia Project. Nalcor acquired the operation on March 31, 2009.

During 2011, earnings from the activities at the Bull Arm site were $3.7 million (2010 – $1.1 million). In 2011, Nalcor finalized a lease agreement for the Bull Arm site with ExxonMobil Canada Properties (ExxonMobil Canada) who will use the site for the Hebron Project. The lease covers the period from 2011 to 2017 and the site will be used for the construction, integration and commissioning of the Hebron GBS. Nalcor is developing a long-term strategy for the site to ensure the success of Bull Arm Fabrication once Hebron exits the site.

Menihek operations: In 2007, Hydro assumed ownership of the Menihek Generating Station from the Iron Ore Company of Canada and entered into a 40-year power purchase agreement to supply electricity from this facility to Hydro-Quebec for its customers in the Schefferville region. Revenue was $1.4 million for 2011 (2010 - $1.3 million) and with certain cost recoveries from Hydro-Quebec, resulted in net income of $1.9 million (2010 - $1.5 million).

Electricity sales to mining industry: Electricity sales to the iron ore industry in Labrador are from two sources. The first is through Churchill Falls' joint venture, Twin Falls, and the second is through direct sales by Hydro sourced from recall power. These direct sales in 2011 were $4.6 million compared to $5.5 million in 2010. Net earnings were $1.9 million in 2011 and $3.0 million in 2010.

Business Development: Business Development includes activities related to wind development, research and development and other business opportunities. During 2011, the Business Development group continued activity associated with the Wind-Hydrogen-Diesel Energy Project in Ramea. This research and development project uses wind and hydrogen technology to supplement the diesel requirements of this isolated community and has the potential to offset diesel with zero-emission power. The project aims to develop a wind-hydrogen-diesel energy solution designed for small-scale energy production in isolated locations.

In 2011, these activities were not in a commercial stage and as a result did not produce any revenues. Costs expensed and capitalized in 2011 were $0.6 million (2010 - $1.1 million) and $0.7 million (2010 - $2.2 million), respectively.

Other: Investments in LCDC and GIPCo are included in this category. Both companies are inactive and had minimal transactions in 2011 and 2010.

Corporate costs: Costs associated with the operation of Nalcor, the parent company, are recorded in this category. In 2011, operating and other costs were $6.7 million, an increase of $1.5 million over 2010 costs of $5.2 million. The increase is primarily due to increased salaries and benefits expense.

During 2011, Nalcor recorded a long-term liability of $39.9 million relating to the UCRA. Under the UCRA, Nalcor is required to make annual payments to the Innu Nation of $2.0 million escalated by 2.5% until 2041. The Province has agreed to provide funding to Nalcor to assist in offsetting these payments and as a result Nalcor has also recorded a receivable of $39.9 million.

FINANCIAL CONDITION REVIEW

ASSETS

Total assets were $3,040.9 million at December 31, 2011, an increase of $236.1 million or 8.4% over December 31, 2010. There were a number of contributing factors to the increase in assets. Nalcor invested $63.2 million related to the development of oil and gas properties (2010 - $82.7 million) and invested $191.4 million in property, plant and equipment (2010 - $113.6 million). These additions were, in part, offset by amortization of $58.5 million (2010 - $56.9 million) and depletion of $29.2 million (2010 - $10.6 million).

Accounts receivable increased by $70.0 million primarily due to funding receivable from the Province related to the UCRA, sinking fund investments increased by $38.6 and the reserve fund increased by $6.1 million. These increases were offset by a decrease in long-term receivables of $24.4 million due to the refund of deposits from Hydro-Quebec TransEnergie related to applications for transmission service through Quebec and a reduction in cash and cash equivalents of $25.8 million.

LIABILITIES

Total liabilities increased by $73.9 million from $1,539.4 million at December 31, 2010, to $1,613.3 million at December 31, 2011. The increase in liabilities was due to an increase in long-term payables of $38.1 million primarily due to Nalcor's obligations under the UCRA, an increase in asset retirement obligations of $10.0 million, an increase in regulatory liabilities of $11.1 million and an increase in deferred credits of $8.7 million primarily due to deferred funding received from the Province.

EQUITY

Total Shareholder's equity increased by $162.2 million from $1,265.4 million to $1,427.6 million in 2011. This increase is due primarily to the 2011 earnings of $126.7 million, an increase in accumulated other comprehensive income of $19.1 million due to mark-to-market adjustments on sinking fund and reserve fund investments and an equity contribution from Nalcor's Shareholder in the amount of $16.4 million.

LIQUIDITY AND CAPITAL RESOURCES

SOURCES AND USES OF CASH

Liquidity requirements are met through a variety of sources, including funds from operations, short-term borrowings, issuance of long-term debt and contributed equity capital.

Cash flows relating to operating, investing and financing activities are summarized in the following table:

millions of dollars	2011	2010
Cash provided by (used in)		
Operating activities	$ 167.8	$ 211.2
Financing activities	63.2	11.1
Investing activities	(256.8)	(191.8)
Net (decrease) increase in cash	$ (25.8)	$ 30.5

Nalcor's primary uses of funds during 2011 were operating expenses and capital spending, including expenditures for the Lower Churchill Project and oil and gas properties. Cash from operating activities includes net earnings, other non-cash items and working capital. Cash from operating activities of $167.8 million decreased from the prior year due to adjustments for non-cash working capital. Investing activities included $191.4 million in plant and equipment; $63.2 million related to oil and gas investments; sinking fund and reserve fund investments of $30.1 million and proceeds from the disposition of property, plant and equipment of $4.7 million. Cash generated from financing activities of $63.2 million was primarily due to an equity injection of $16.4 million and an increase in long-term payables of $38.1 million.

Throughout 2011, Nalcor maintained a demand operating facility with a limit of $100.0 million, with covenants that restricted the issuance of debt such that the unconsolidated debt to total capitalization ratio could not exceed 70%. The covenants further stipulated that the Debt Service Coverage Ratio should at all times be greater than 1.5 to 1.0 on an unconsolidated basis. At December 31, 2011, Nalcor was in compliance with these ratios. The facility was unencumbered at the end of 2011 with the exception of a $0.3 million letter of credit outstanding.

Nalcor's subsidiary, Hydro, maintains a short-term promissory note program for funding its ongoing requirements. This program has an authorized limit of $300.0 million and is guaranteed by the Government. The current credit rating of R1 (low) assigned to this program by Dominion Bond Rating Service (DBRS), combined with the Province guarantee, allows Hydro access to short-term funds in the Canadian Money Market at attractive rates. At December 31, 2011, there were no short-term notes outstanding. Throughout 2011, Hydro also maintained a $50.0 million unsecured demand operating credit facility and with the exception of letters of credit outstanding of $18.9 million, this bank credit facility was unencumbered at the end of 2011.

Capital markets are the principal source of longer-term funding for Hydro. Hydro's debenture issues are currently assigned an "A" credit rating by DBRS, and are also fully guaranteed by the Province. Hydro's total borrowings outstanding, net of sinking funds, are limited by legislation to $1.6 billion. As of December 31, 2011, $892.7 million was outstanding (2010 - $936.5 million).

The operations of Churchill Falls are financed by cash flow from operations. Unsecured bank credit facilities are also in place in the amount of $10.0 million and with the exception of a letter of credit outstanding of $1.0 million, this bank credit facility was unencumbered at the end of 2011.

The operating and capital requirements of Oil and Gas are financed by funds from operations and injections of equity capital from Nalcor. During 2011, revenue from the sale of crude oil was realized from the White Rose Growth Project and the Hibernia Southern Extension. These revenues, in conjunction with equity injections from Nalcor, were used to offset operating costs and investments in oil and gas assets. Oil and Gas also maintained a $5.0 million demand operating credit facility to meet short-term operating requirements. Until such time as Oil and Gas has an earnings and credit profile sufficient to support entry into either the money markets or the capital markets, any financing required to supplement earnings from operations will occur from Nalcor in the form of equity injections, as Oil and Gas currently has $4.7 million in letters of credit outstanding against the $5.0 million demand operating facility. At such time, management will review the funding strategy to ensure continued appropriateness.

Bull Arm Fabrication's short-term liquidity requirements are met by a combination of cash and cash equivalents on hand and funds from operations.

ACCESS TO WORKING CAPITAL

Cash flow from operations and the availability of short-term funding under Nalcor's $100.0 million demand operating facility are considered sufficient to meet working capital requirements. Covenants under the credit facility are intact and draw downs to date have been without incident. Borrowing costs under the credit facility are based on Banker's Acceptance (BA) rates plus a stamping fee of 50 basis points or the Prime Rate, depending on which borrowing option is chosen.

Hydro's short-term debt is rated as R1 (low) by DBRS and A-1 high by Standard and Poors. Both are investment grade credit ratings that facilitate Hydro's access to short-term capital markets. Hydro sells a large portion of its energy to Newfoundland Power, which is a regulated distribution utility in the province and whose First Mortgage Bonds are rated by DBRS as an "A" credit. Hydro continues to obtain short-term funding through its promissory note program. The notes issued under this program are guaranteed by the Province. During 2011 Hydro issued $31.0 million in short-term debt under this program (2010 - $12.0 million). At year end there were no promissory notes outstanding. Since December 31, 2011, Hydro has issued an additional $146.0 million in promissory notes. The promissory note program is backed by a $50.0 million demand operating credit facility.

Churchill Falls' primary revenue stream is fixed at pricing under a long-term power contract with Hydro-Quebec. Churchill Falls' cash requirements are funded by cash from operations with periodic working capital needs met through ready access to cash and high quality short-term investments. At year end, Churchill Falls had access to $27.6 million in cash and highly-liquid short-term investments. It also had access to a reserve fund totaling $69.0 million for use in meeting unanticipated capital expenditures.

To date, working capital requirements of Oil and Gas have been met through contributions of equity capital from Nalcor. During 2011, this funding source was augmented by funds from Oil and Gas operations which consisted almost entirely of sales from White Rose and Hibernia Southern Extension production. Consequently, these funds from operations were subject to fluctuations in both the market price of crude oil and the US/Canada currency exchange rate. This exposure was managed in accordance with Nalcor's corporate Financial Risk Management Policy. A demand operating credit facility of $5.0 million provided access to additional working capital as required.

CAPITAL STRUCTURE

Nalcor's debt and equity and related ratios are shown in the following table:

millions of dollars	2011	2010
Current portion long-term debt	$ 8.2	$ 8.2
Long-term debt (net of sinking funds)	884.5	928.3
Total debt	$ 892.7	$ 936.5
Shareholder's equity	$1,427.6	$ 1,265.4
Total debt to capital [1]	38.5%	42.5%
Fixed rate debt as percentage of total indebtedness [2]	100%	100%
EBIT to interest coverage [3]	$ 2.5	$ 2.0
FFO to debt [4]	20.0%	13.5%

(1) *Debt to capital – Total debt (promissory notes, long-term debt including current portion less sinking funds), divided by debt plus shareholders' equity.*

(2) *Long-term debt divided by total debt.*

(3) *EBIT divided by gross interest. Earnings before interest and taxes includes interest income net of guarantee fees. Gross interest is interest expense before interest income, guarantee fee, capitalized interest, accretion and foreign exchange provision.*

(4) *FFO to debt – Funds from operations (cash flow from operations less post retirement benefits paid less capitalized interest plus or minus changes in working capital) divided by Debt (total debt less post retirement benefit obligations less accrued interest).*

Nalcor's capital structure is key to its ability to execute its long-term strategy. Nalcor has significantly improved its financial strength over the past several years which has positioned Nalcor to facilitate growth and re-investment. This

financial strength results in access to lower-cost debt and has allowed Nalcor to pursue strategic partnering opportunities. This also enables growth activities, such as the Lower Churchill Project, Oil and Gas investments and large capital investments in Hydro Regulated and Churchill Falls as part of Nalcor's long-term asset management plan.

Nalcor's primary objectives when managing capital are to minimize its cost of capital within the confines of established risk parameters and to safeguard Nalcor's ability to continue as a going concern. Nalcor's approach to capital management is performed on a consolidated basis. Management monitors the capital requirement for each subsidiary individually.

Nalcor measures its capital structure using the key measures of debt to capital, earnings before interest and tax (EBIT) to interest coverage, funds from operations (FFO) to debt, weighted average term to maturity and the fixed to floating rate debt ratio to monitor its capital structure. Both the weighted average term to maturity and the fixed to floating debt ratio are periodically compared to utility industry benchmarks and if deemed appropriate, adjustments to the capital structure are made. During 2010 and 2011, Nalcor realized a significant improvement in the debt to capital ratio as a result of strong earnings and contributed capital received from the Province of $57.0 million over two years. This equity funding, combined with a policy to reinvest all earnings, resulted in a significant reduction in leverage in Nalcor's capital structure. EBIT to interest coverage improved year over year due to increased earnings with relatively stable interest costs. During 2011, Nalcor also significantly improved its FFO to debt ratio as an indicator of its ability to cover debt with cash generated on an annual basis. This improvement is due to an increase in cash flows from operations.

The proportion of fixed rate debt as a percentage of total indebtedness remained at 100% at the end of 2011. The stability of fixed rate percentage year over year was due to cash management activity that resulted in positive cash balances throughout the year. Consequently, there was a reduction in floating rate debt as there were no promissory notes outstanding at year end.

OBLIGATIONS AND COMMITMENTS

Obligations and commitments for the five-year period 2012 to 2016 are as follows:

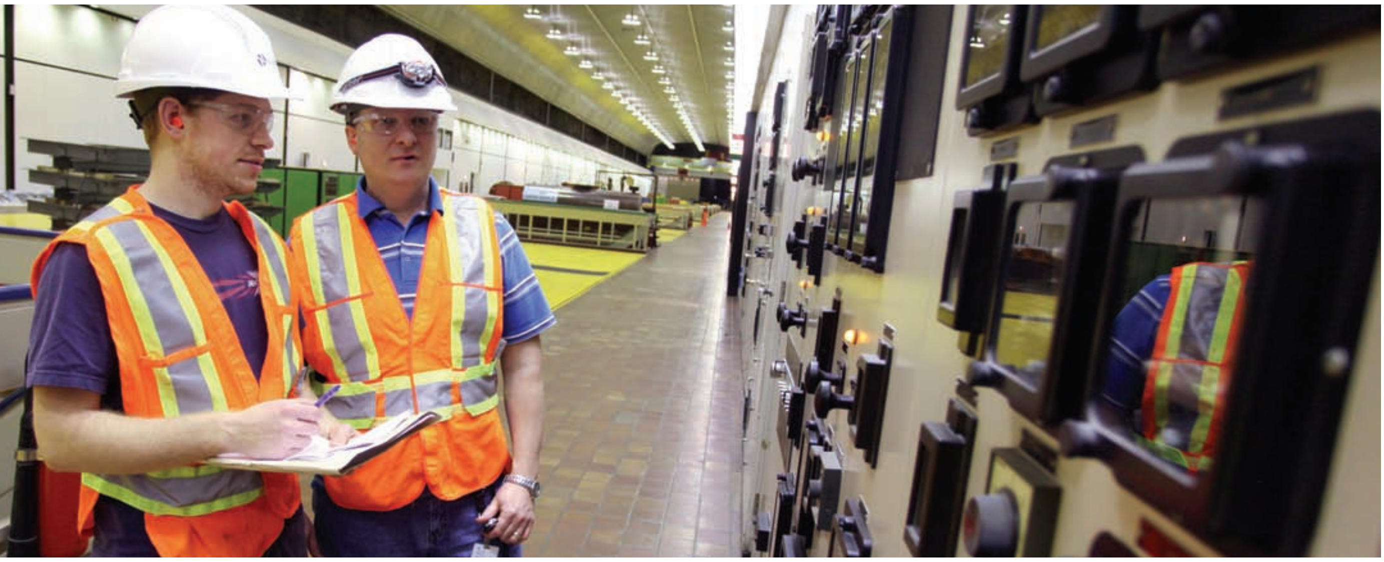
millions of dollars	2012	2013	2014	2015	2016
Debt repayments [1]	$ -	$ -	$ 125.0	$ -	$ 225.0
Sinking fund installments	8.2	8.2	8.2	8.2	8.2
Reserve fund payments[2]	5.3	-	-	-	-
Power purchase agreements[3]	24.8	25.5	26.1	26.8	27.3
Transmission capacity [4]	19.0	19.0	4.8	-	-
Total	$ 57.3	$ 52.7	$ 164.1	$ 35.0	$ 260.5

(1) *Includes repayment of long-term debt.*

(2) *In accordance with the shareholder's agreement, Churchill Falls is required to establish a $75.0 million Reserve Fund for major repairs, which commenced with an initial payment January 2007. The amount represents Nalcor's 65.8% share of the payment.*

(3) *Hydro has entered into a number of power purchase agreements with remaining terms ranging from 15 to 25 years.*

(4) *Hydro has the right to renew its transmission service contract at the end of the contract term.*



RELATED PARTY TRANSACTIONS

Nalcor enters into various transactions with its parent, subsidiaries and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Nalcor transacts with the following related parties:

Related party	Relationship
The Province	100% shareholder of Nalcor.
Churchill Falls	Jointly controlled subsidiary of Hydro.
Twin Falls	Jointly controlled subsidiary of Churchill Falls.
The Trust	Created by the Province with Churchill Falls as the beneficiary.
PUB	Agency of the Province.

Intercompany transactions and balances have been eliminated upon consolidation. The amounts included in the Consolidated Financial Statements for related party transactions are as follows:

	The Province	Other Affiliates	Total
millions of dollars		**2011**	
Revenue	**$ 4.2**	**$ -**	**$ 4.2**
Expenses	**(18.0)**	**1.9**	**(16.1)**
Accounts receivable	**40.5**	**0.6**	**41.1**
Accounts payable and accrued liabilities	**19.4**	**0.6**	**20.0**
Deferred credits	**10.4**	**-**	**10.4**
millions of dollars		2010	
Revenue	$ 7.1	$ -	$ 7.1
Expenses	16.3	1.3	17.6
Accounts receivable	0.9	1.8	2.7
Accounts payable and accrued liabilities	10.5	0.1	10.6
Deferred credits	2.5	-	2.5

The related party transactions included in the financial statements are described in Note 21 of the Consolidated Financial Statements.

SECTION 3: RISK MANAGEMENT PROCESS

Nalcor Energy is committed to identifying and managing risk in a manner that supports disciplined corporate planning and strategy as the business grows and its risk profile continues to evolve. Nalcor's Leadership Team provides senior management oversight of risk. Nalcor focuses on an execution of risk management and mitigation strategies in each line of business utilizing a common risk framework and toolset.

During 2010, the Board approved a five-year Enterprise Risk Management (ERM) plan for Nalcor which included endorsement of a framework that will be consistent with Risk Management Guidelines and Principles per ISO/CSA 31000. Management is responsible for the ongoing monitoring and review of the Corporations's risk profile and for ensuring that the ERM framework is fully operationalized according to the five-year ERM plan.

There is also an ERM committee, the principle mandate of which is to assist in developing, implementing, managing and continuously maintaining best practice standards and procedures within Nalcor's ERM framework. This committee consists of membership from across the various lines of business, with subject matter expertise in the area of risk management. In addition, a risk representative, who is responsible for ensuring that risk management policy and related mitigation strategies are carried out, has been appointed in each line of business.

Risks are identified at the business unit level and rated according to severity and likelihood of occurrence. Mitigation strategies are devised for highly-rated risks and these strategies form an integral part of the related business plan. Mitigation strategies include initiatives such as insurance contracts, hedging transactions, asset management and capital improvements.

Risk management is viewed not only as a means by which risks are identified and mitigated as appropriate, but also as a means by which business opportunities can be identified and assessed. While recognizing that some acceptance of risk is a necessary part of doing business, Nalcor endeavors to accept only those risks that help ensure competitive advantage and that are within its capability to withstand.

The Internal Audit function also assists Nalcor in achieving its business objectives by providing a systematic evaluation of the effectiveness of risk management, cost control and governance processes. Opportunities for improving management control may also be identified during the audits.

Nalcor's ERM framework is based on four major categories of risk: strategic, operational, financial and compliance-related risks.

STRATEGIC RISK

The Leadership Team has identified key strategic risks within each line of business and accepted those that might provide competitive advantage. Others have been analyzed in the context of Nalcor's ability to withstand the attendant risk and mitigation strategies have been formulated for risks carrying a higher rating. Strategic opportunities and mitigation strategies identified as a result of this process are integrated with the corporate planning process.

OPERATIONAL RISK

Risks are identified and assessed based on the probability and severity of a potential occurrence. Events that could have a significant impact on corporate strategic goals are identified and mitigation procedures are effected to provide reasonable assurance that such events will not prevent achievement of corporate goals and objectives. Through continual updating of risk management practices, Nalcor ensures the protection of all physical and financial assets.

This category of risk includes: major damage to critical assets; interruption of electrical service; and liability to third parties arising from property damage or loss, bodily injury or loss of life. To eliminate or lessen the impact of this risk, Nalcor has developed regular maintenance, inspection and insurance programs and initiated redundancy of critical assets.

The corporate insurance program, covering all assets and specified liabilities, is reviewed and updated annually. The review focuses on exposures to loss, insurable values, coverage limits, deductibles, self-insured retentions and loss analysis. Statistics and information compiled during the annual review are utilized to develop renewal strategies resulting in the acquisition of comprehensive coverage at competitive cost.

Each operational area and facility within Nalcor has developed comprehensive response plans to provide guidance and contingency processes in the event of emergency. The plans are based on consideration of adverse events that each area or facility might be subject to in the course of their operations such as fire, explosion, equipment failure, and natural events such as floods and ice storms. Nalcor has also established emergency response plans at the corporate level, which provides for executive level and functional support from service areas such as safety, health, environment, human resources, engineering and communications. In addition to contingency planning for response at the time of occurrence and in the immediate post-emergency time frame, longer-term planning for business continuity related issues is also an ongoing priority.

Nalcor has established an Office of Asset Management to ensure it manages its assets effectively and consistently to maximize plant availability and minimize cost through a consistent framework and process across the Corporation.

SAFETY

The pursuit of safety excellence is a critical focus at Nalcor and its lines of business, which is significantly strengthened by a strong partnership between the company and its union, the IBEW, on all matters related to safety. Safety is reinforced throughout the organization through the development of a set of core values which include safety; a Safety Credo; formal documentation of an Internal Responsibility System for safety and the delivery of the BeSafe Safety coaching framework workshops delivered to employees in the company. Key safety processes are continuously reviewed and updated including: work protection code, work method development, contractor safety management, safety performance communication and personal hazard assessment.

INFORMATION TECHNOLOGY

Information technology affects all aspects of Nalcor's operations. Major risk exposures in this environment relate to information security (e.g., loss of processing capability due to hardware/software failure or threat of virus attacks) and availability of information (e.g., loss of communication across the wide area network).

With respect to information security, Nalcor has retained a service provider to help restore critical business systems. The service provider supplies a back-up site along with all the necessary hardware and communication links. Nalcor maintains a Disaster Recovery Plan that details actual recovery procedures and processes and is updated and tested on a periodic basis. The Energy Management System that controls Hydro's generation and transmission activities has a backup Energy Control Centre in a separate facility.

External threats to Nalcor's computer systems are mitigated through the use of firewalls, anti-virus tools and detection/intrusion prevention appliances. Internet access is tightly controlled and managed by a web-filtering device that reduces the risk of potential computer viruses.

ENVIRONMENTAL

The number and diversity of environmental risks facing Nalcor requires a structured and consistent management approach. Nalcor applies the ISO 14001 Environmental Management System (EMS) standard developed by the International Organization for Standardization to its Hydro and Churchill Falls subsidiaries to drive continual improvement in mitigating environmental risks, while providing customers with safe, reliable electricity. Nalcor is also committed to the use of the EMS for its other lines of business.

Targets for improvements in environmental performance for these lines of business are established and monitored as part of the corporate goals and objectives. Nalcor mitigates environmental risk through adherence to the various principles of the EMS, which include periodic internal environmental compliance audits, surveillance audits by an outside contractor and recertification as ISO 14001 compliant.

REGULATORY

Rates that Hydro Regulated charges for the provision of electrical service are established by the PUB. The ability to recover the actual costs of providing service depends on achieving forecasts established in the rate setting process. During 2009, the Province issued an Order in Council which provided Hydro with the ability to earn a rate of return equal to the rate approved from time to time by the PUB for Newfoundland Power effective subsequent to Hydro's next rate application.

GROWTH ACTIVITIES

As Nalcor considers future growth activities in the energy sector, it may be subject to a number of risks. As investment opportunities are evaluated, strategies will be devised to mitigate identified risks.

FINANCIAL RISK

Nalcor operates in an environment with various forms of financial risk, including credit, liquidity and market risk. In compliance with a Board-approved Financial Risk Management Policy, Nalcor utilizes a combination of derivative financial instruments, portfolio management, counterparty credit monitoring and financing activities to manage these risks.

CREDIT RISK

Nalcor is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. Procedures and practices designed to manage the credit risks associated with the various business activities throughout Nalcor include assessment and monitoring of counterparty creditworthiness, setting of credit limits and various forms of credit assurance. The majority of receivables are from regulated utilities and retail consumers, which minimizes credit risk.

Nalcor manages its cash investment credit risk exposure by restricting its investments to high-quality securities. Investments held within the sinking fund portfolios of Hydro and the reserve fund in Churchill Falls are limited to securities issued by provincial governments and Schedule 1 Canadian banks. In addition, investments held within the reserved fund portfolio of Churchill Falls do not exceed 10% with any one entity with the exception of the Government of Canada. Derivative transactions are executed with only highly-rated banking institutions. Credit risk related to the sale of recall power is managed through contractual arrangements with creditworthy counter parties, supported by credit enhancements as appropriate.

LIQUIDITY RISK

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Short-term liquidity is provided by cash and cash equivalents, funds from operations and maintenance of borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations. Cash flows are monitored continuously. Long-term liquidity is provided through the issuance of debentures in the capital markets and injections of equity capital in support of large project investments.

The funding obligations associated with the longer-term debentures are managed through a balanced approach to debt maturity and a program of sinking fund investment. Debt maturities are managed to avoid overly demanding funding requirements in any given year.

MARKET RISK

Interest Rates: Nalcor has a $100.0 million demand operating facility. Hydro's short-term funding is managed under a Provincially-guaranteed promissory note program having a $300.0 million limit and a $50.0 million demand operating facility with its banker. Churchill Falls and Oil and Gas both maintain demand operating facilities in the amount of $10.0 million and $5.0 million, respectively.

Nalcor annually establishes clear guidelines for exposure to short-term interest rates. These exposure limits are reset annually based on ongoing benchmarking against key indices, coupled with the performance of sensitivity analysis against established risk tolerance levels for each subsidiary. In this manner, Nalcor attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Foreign Exchange and Commodity Prices: Nalcor's primary exposure to both foreign exchange and commodity price risk arises from Hydro's purchases of No. 6 fuel for consumption at its Holyrood Thermal Generating Station; the sale of recall power at USD market rates; USD denominated sales of crude oil by Oil and Gas; USD denominated capital expenditures in Oil and Gas; and USD denominated lease revenue in Bull Arm Fabrication. Management of foreign exchange risk and commodity price risk is governed by the Financial Risk Management Policy approved by the Board.

Hydro Regulated's exposure on the purchase of No. 6 fuel is mitigated through the operation of the RSP. Hydro Regulated employs the periodic use of forward contracts as a means by which future exposure to exchange rate fluctuations on any given day can be avoided. As at December 31, 2011, there were no forward contracts outstanding in connection with No. 6 fuel purchases.

Foreign exchange exposure on sales of recall power is managed through a combination of portfolio management and derivative hedging instruments. During 2009, Hydro entered into a series of forward contracts to hedge the CAD/USD exposure on 75% of budgeted recall sales for the 24-month period from April 2009 to March 2011. The contracts provided Hydro with a fixed rate of $1.17 CAD/USD on USD $87.9 million in recall sales, leaving the remainder of recall sales exposed to the prevailing rate for CAD/USD. In 2011 Hydro entered into another series of forward contracts to hedge the CAD/USD exposure on 75% of budgeted recall power sales for the period April 2011 to December 2011. The contracts provided Hydro with a fixed rate of $1.00 CAD/USD on USD $35.7 million in recall sales, leaving the remainder of recall sales exposed to the prevailing rate for CAD/USD during the period.

Commodity price exposure on sales of recall power is managed through derivative hedging instruments. During 2011, Hydro entered into a series of commodity price swaps to hedge the exposure to market prices on approximately 61% of planned sales for the period from February 2011 to December 2011. These contracts swapped the floating market price for an average fixed price of $35.37 USD/MWh on recall sales of $27.8 million USD, leaving Hydro positioned to receive the prevailing market rate on remaining sales in the period.

Commodity price exposure on sales of crude oil is managed through derivative hedging instruments. During 2011, Oil and Gas entered into commodity price swaps to hedge commodity price risk on 35% of its planned sales covering the period from March 2011 to December 2011. These contracts, which swapped floating market prices for fixed prices, provided Oil and Gas with an average fixed rate of $100.53 USD/BBL on USD $17.4 million in sales, leaving the remaining sales exposed to the prevailing market rates for the period. Foreign exchange exposure on USD crude oil sales is mitigated through Oil and Gas' capital expenditures, a significant portion of which are denominated in USD.

Commodity price and foreign exchange risks, pertaining to both energy sales and oil and gas investments, are managed in a manner that considers Nalcor's earnings quality and planned objectives. As added foreign exchange and commodity price exposures emerge, they are managed in accordance with the Financial Risk Management Policy.

COMPLIANCE RISK

Nalcor is exposed to varying aspects of compliance risk across its lines of business. Each line of business is required to assess their risk of non-compliance and to consider mitigation strategies in instances that have a high pre-mitigation risk rating. These include compliance with provincial legislation, regulatory directives, environmental standards, debt covenants, accounting standards and with a wide variety of contractual arrangements affecting both revenues and expenditures.

In all these risk areas, Nalcor has identified, rated and mitigated each risk as appropriate and ensured their consideration as part of the corporate business planning process.

SECTION 4: CRITICAL ACCOUNTING ESTIMATES

Nalcor's discussion and analysis of its financial condition and results of operations are based on its audited Consolidated Financial Statements, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP).

Significant accounting policies are contained in Note 2 to the audited Consolidated Financial Statements. Some of these policies involve critical accounting estimates requiring subjective or complex judgments that are inherently uncertain which could result in materially different amounts under different conditions or using different assumptions. Management has discussed the development, selection, and application of its key accounting policies and the critical accounting estimates and assumptions they involve with the Audit Committee of the Board of Directors, and it has reviewed the disclosures described in this section.

The following section discusses the critical accounting estimates and assumptions that management has made and how they affect the amounts reported in the audited Consolidated Financial Statements. Nalcor considers these estimates to be an important part of understanding its financial statements.

EMPLOYEE FUTURE BENEFITS

Nalcor provides pensions and other retirement benefits for most of its employees. The accounting estimates related to the cost of its employee benefit plan are critical accounting estimates because the derived estimates are based on the use of various key assumptions and differences in actual results or changes in assumptions could materially affect Nalcor's Consolidated Financial Statements.

Due to the long-term nature of these plans, the calculation of expenses and obligations depends on various assumptions such as discount rates, health care cost trend rates, projected salary increases, retirement age, mortality and termination rates. These assumptions are determined by management and reviewed by Nalcor's actuaries.

The discount rate reflects the weighted average interest rate at which the other post-retirement liabilities could be effectively settled using high-quality bonds at the measurement date. Based on employee demographics and expected future benefit and medical claims, payments are measured and discounted to determine the present value of the expected future cash flows. The cash flows are discounted using yields on high-quality AA-rated non-callable bonds with cash flows of similar timing. Other assumptions are based on actual experience and best estimates.

Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation in future periods. These differences relate primarily to actual actuarial gains/losses incurred on the benefit obligation versus those expected, as recognized in the Consolidated Financial Statements. For further details on the annual expense and obligation, see Note 12 to the Consolidated Financial Statements.

ASSET RETIREMENT OBLIGATIONS

Nalcor recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of fair value can be determined. Determining asset retirement obligations requires estimates in relation to the expected life of the asset and the costs of demolition, dismantlement, restoration and remedial work that would be required.

IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT

Nalcor reviews the carrying value of its development projects at the end of each accounting period and reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. When applicable, an impairment loss would be recognized equal to the amount by which the carrying amount exceeds the fair value. Various assumptions and accounting estimates are required to determine whether an impairment loss should be recognized and if so, the value of such loss. This includes factors such as short-term and long-term forecasts of the future market price of electricity and fuel, the demand and supply of electricity and fuel, the in-service dates of new generating stations, inflation, capital expenditures and station lives. The amount of future net cash flow that Nalcor expects to receive from its property, plant and equipment could differ materially from the net book values recorded in its Consolidated Financial Statements.

FULL COST ACCOUNTING FOR PETROLEUM AND NATURAL GAS PROPERTIES

Nalcor reviews the carrying value of its development projects at the end of each accounting period. The carrying value of petroleum and natural gas properties, as well as the corresponding DD&A expense, is based on estimates of costs to develop proved undeveloped reserves, proved oil and gas reserves and future net cash flows from proved reserves.

REGULATION

Generally, the accounting policies applicable to Hydro are subject to examination and approval by the PUB. These accounting policies may differ from those used by entities not subject to rate regulation. The timing of the recognition of certain assets, liabilities, revenues and expenses may differ from that otherwise expected using Canadian GAAP for entities not subject to rate regulation. Regulatory assets and regulatory liabilities arise as a result of the rate-setting process and have been recorded based on previous, existing or expected future regulatory orders. Certain estimates are necessary until these amounts are finalized pursuant to regulatory decisions or other regulatory proceedings. The final amounts approved by the PUB for deferral as regulatory assets and regulatory liabilities and the approved recovery or settlement periods may differ from those originally expected. Any resulting adjustments to original estimates are reported in earnings in the period in which they become known. As at December 31, 2011, Hydro Regulated had $66.4 million in current and long-term regulatory assets

(2010 - $69.7 million) and $170.9 million in current and long-term regulatory liabilities (2010 - $159.8 million). The nature of Hydro Regulated's regulatory assets and liabilities is described in Note 6 to the Consolidated Financial Statements.

USEFUL LIFE OF CAPITAL ASSETS

Property, plant and equipment are amortized over their estimated service lives. Estimated service lives are determined based on the anticipated physical life of the asset, technological obsolescence and past experience, and are reviewed regularly to ensure that they continue to be appropriate.

Amortization is an estimate based primarily on the anticipated useful life of assets that reflects current facts and historical information. Nalcor's consolidated property, plant and equipment represents approximately 69% of total consolidated assets as at December 31, 2011 (2010 - 70%). Amortization expense associated with property, plant and equipment was $57.8 million during 2011 (2010 - $56.8 million). Due to the size of Nalcor's property, plant and equipment, changes in amortization rates can have a significant impact on amortization expense.

During 2010, Hydro Regulated completed an amortization study as a follow-up to the 2005 study conducted pursuant to Order No. P.U. 7 (2002 - 2003). The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances at December 31, 2009. Based on the results of this study, management currently estimates that switching from the use of the sinking fund to straight-line amortization for hydroelectric and transmission assets as well as changing from unit-based amortization to a group-based method on remaining life basis and implementing the recommended service lives will result in an estimated decrease of $1 million in the annual amortization expense.

In December 2011, Hydro Regulated filed an application with the PUB to change the depreciation methodology to straight-line depreciation for all assets and to adopt the service lives as recommended by the study. The application is currently being reviewed by the PUB.

CAPITALIZED OVERHEAD

As approved by the PUB, Hydro Regulated capitalizes overhead costs that are not directly attributable to specific capital assets but which relate to the overall capital program. This capital overhead is allocated to property, plant and equipment and amortized over their estimated service life. In 2011, $2.6 million was allocated (2010 - $2.1 million). Any change in the methodology of calculating and allocating general overhead costs to property, plant and equipment could have a significant impact on the amount recorded as operating expenses and property, plant and equipment assets.

CONTINGENCIES

Nalcor is subject to various legal proceedings and claims associated with the ordinary course of business operations. It is management's judgment that the amount of liability, if any, from these actions would not have a material adverse effect on Nalcor's financial position or results of operations.

SECTION 5: ACCOUNTING CHANGES

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In October 2010, the Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2012. Nalcor is a qualifying entity and chose to use the deferral option.

Nalcor commenced its IFRS conversion project in 2008 and established a formal project governance structure which included a steering committee consisting of senior levels of management from various disciplines, as appropriate. Reporting is provided to the Leadership Team and the Audit Committee of the Board of Directors. In addition to dedicated internal resources, Nalcor had also engaged an external advisor to assist in the IFRS conversion project.

Although IFRS and Canadian GAAP are based on a similar conceptual framework, there are a number of differences in recognition, measurement and disclosure. The areas with the highest potential impact on Nalcor are property, plant and equipment, regulatory assets and liabilities, investment in subsidiaries and petroleum and natural gas properties.

ACCOUNTING POLICY DECISIONS AND IMPACTS

The following discussion provides further information about Nalcor's policy choices upon transition to IFRS.

Regulatory Assets and Liabilities

Nalcor currently uses certain accounting policies specific to rate-regulated activities under Canadian GAAP which permit the recognition of regulatory assets and liabilities. The International Accounting Standards Board (IASB) has deferred its work on the rate-regulated activities accounting project and has not provided any interim guidance for the recognition and measurement of regulatory assets and liabilities. The concept of rate regulatory accounting does not exist under current IFRS. The inability to recognize regulatory assets and liabilities after implementing IFRS in 2012 may have a significant impact on Nalcor's earnings due to a change in the timing of recognition of revenues and expenses. In December 2011, Hydro applied to the PUB for approval to use IFRS as the basis for regulatory reporting. Hydro Regulated will, however, maintain regulatory assets for rate making purposes on a go forward basis.

Property, Plant and Equipment

International Accounting Standard (IAS) 16 – Property, Plant & Equipment, requires that significant parts of an asset be depreciated separately. Nalcor completed a review of its asset records and modifications were made where necessary, to ensure compliance with IAS 16. IAS 16 also permits property, plant and equipment to be measured using the fair value model or the cost model. Nalcor has chosen to adopt the cost model which results in no change from the current measurement policy under Canadian GAAP.

IAS 16 also requires the cost of an asset to be reduced by the systematic allocation of depreciation over the asset's useful economic life. Nalcor has determined that sinking fund depreciation used on certain assets in Hydro Regulated is not appropriate under IFRS and will adopt the straight-line method upon transition.

In May 2010, the IASB amended IFRS 1 such that entities with rate-regulated activities could elect to use the carrying amount of items of property, plant and equipment as deemed cost at the date of transition to IFRS. Nalcor currently intends to apply this exemption.

Investment in Subsidiaries

Nalcor owns 65.8% of Churchill Falls through its 100% owned subsidiary, Hydro. Due to the 1999 shareholders agreement between Hydro and Hydro-Quebec, the nature of

the relationship is that of joint venturers. Since the activities are classified as those of a joint venture, Nalcor intends to account for its investment in Churchill Falls as an equity investment and will no longer proportionately consolidate its share of the results and activities of this entity.

Petroleum and Natural Gas Properties

Under Canadian GAAP, Nalcor follows the CICA's guideline on full cost accounting in which all costs directly associated with the acquisition of, exploration for, and development of oil and gas reserves are capitalized on a country-by-country cost centre basis. Costs accumulated within each country are depleted using the unit-of-production method based on proved reserves.

Under IFRS, Nalcor will continue to deplete capitalized costs using the unit-of-production method; however, Nalcor has chosen to deplete these costs based on proved plus probable reserves.

Under IFRS, Nalcor will also adopt new accounting policies associated with pre-exploration costs, exploration and evaluation costs and development costs. Under Canadian GAAP, pre-exploration costs are capitalized and depleted within the cost centre. Under IFRS these costs must be expensed. Exploration and evaluation costs will continue to be capitalized under IFRS until the project is determined to be technically feasible and commercially viable, at which point the costs would be transferred to property, plant and equipment. Under IFRS, Nalcor will continue to capitalize development costs; however, these costs will be depleted on a unit-of-production method on a cash-generating unit level instead of the country cost centre level. Under Canadian GAAP, unproved properties are excluded from the calculation of DD&A until proved reserves are assigned or the property becomes impaired. Under IFRS, Nalcor will test exploration and evaluation costs for impairment at the cash-generating unit level which means that once it is determined that a property is not commercially viable, an impairment loss is recognized in profit or loss.

During 2012, Nalcor will continue to review all proposed and continuing projects of the IASB, closely monitor any initiatives of the International Financial Reporting Interpretations Committee with potential to impact financial reporting and will participate in related initiatives as appropriate.

MANAGEMENT REPORT

The accompanying Consolidated Financial Statements of Nalcor Energy, and all information in the Business and Financial Report, are the responsibility of management and have been approved by the Board of Directors.

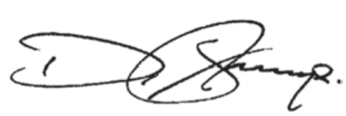
The Consolidated Financial Statements have been prepared by management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on management's 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 March 23, 2012. Financial information presented elsewhere in the Business and Financial Report is consistent with that in the Consolidated 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 Consolidated 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 Consolidated 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.

Ed Martin
President and Chief Executive Officer



Derrick Sturge
Vice President, Finance and Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

To the Lieutenant-Governor in Council

Province of Newfoundland and Labrador

We have audited the accompanying consolidated financial statements of Nalcor Energy, which comprise the consolidated balance sheet as at December 31, 2011 and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Nalcor Energy as at December 31, 2011, and the results of its operations and its cash flows for the year then ended, in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
St. John's, NL
Canada
March 23, 2012

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	2011	2010
ASSETS		
Current assets		
Cash and cash equivalents	18.7	44.5
Short-term investments	16.9	15.7
Accounts receivable (Note 21 p)	163.6	93.6
Current portion of regulatory assets (Note 6)	2.8	3.8
Inventory	63.5	63.0
Prepaid expenses	4.8	4.7
Derivative assets	0.2	2.0
	270.5	227.3
Property, plant and equipment (Note 4)	2,108.6	1,968.7
Petroleum and natural gas properties (Note 5)	304.2	269.2
Regulatory assets (Note 6)	63.6	65.9
Other long-term assets (Note 7)	294.0	273.7
	3,040.9	2,804.8
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	156.1	152.1
Current portion of long-term debt (Note 9)	8.2	8.2
Current portion of regulatory liabilities (Note 6)	137.6	118.9
Deferred credits (Note 21)	11.3	2.6
Derivative liabilities	0.2	0.3
	313.4	282.1
Long-term debt (Note 9)	1,131.5	1,136.7
Regulatory liabilities (Note 6)	33.3	40.9
Asset retirement obligations (Note 10)	24.8	14.8
Long-term payables (Note 11)	42.7	4.6
Employee future benefits (Note 12)	67.6	60.3
	1,613.3	1,539.4
SHAREHOLDER'S EQUITY		
Share capital (Note 13)	122.5	122.5
Contributed capital (Note 13)	390.5	374.1
	513.0	496.6
Accumulated other comprehensive income (Note 14)	46.4	27.3
Retained earnings	868.2	741.5
	914.6	768.8
	1,427.6	1,265.4
	3,040.9	2,804.8

Commitments and contingencies (Note 20)

See accompanying notes

On Behalf of the Board

Ed Martin
Director

Gerald Shortall
Director

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	2011	2010
Revenue		
Energy sales	695.6	588.8
Interest and finance income (Note 17)	20.2	18.0
Other revenue	14.1	13.3
	729.9	620.1
Expenses		
Fuels	156.7	140.4
Power purchased	52.9	44.4
Operations and administration	199.9	181.9
Interest and finance charges (Note 17)	108.4	105.1
Amortization and depletion	87.7	67.5
Other income and expense	(2.4)	3.3
	603.2	542.6
Net income	126.7	77.5
Retained earnings, beginning of year	741.5	664.0
Retained earnings, end of year	868.2	741.5

See accompanying notes

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	2011	2010
Net income	126.7	77.5
Other comprehensive income		
Change in fair value of available for sale financial instruments	31.6	20.6
Change in fair value of derivatives designated as cash flow hedges	0.1	1.1
Amounts recognized in net income	(12.6)	(16.4)
Comprehensive income	145.8	82.8

See accompanying notes

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	**2011**	2010
Cash provided by (used in)		
Operating activities		
Net income	**126.7**	77.5
Adjusted for items not involving a cash flow		
Amortization and depletion	**87.7**	67.5
Accretion of long-term debt	**0.5**	0.4
(Gain) loss on disposal of property, plant and equipment	**(2.7)**	0.7
Unrealized loss on derivative instruments	**0.5**	0.3
	212.7	146.4
Changes in non-cash working capital balances (Note 18)	**(44.9)**	64.8
	167.8	211.2
Financing activities		
Increase in contributed capital	**16.4**	40.6
Increase (decrease) in deferred credits	**8.7**	(0.5)
Long-term debt retired	**-**	(29.3)
Increase in long-term payables	**38.1**	0.3
	63.2	11.1
Investing activities		
Additions to property, plant and equipment	**(191.4)**	(113.6)
Additions to petroleum and natural gas properties	**(63.2)**	(82.7)
Increase in other long-term assets	**(5.7)**	(29.5)
(Increase) decrease in short-term investments	**(1.2)**	33.5
Proceeds on disposition of property, plant and equipment	**4.7**	0.5
	(256.8)	(191.8)
Net (decrease) increase in cash	**(25.8)**	30.5
Cash position, beginning of year	**44.5**	14.0
Cash position, end of year	**18.7**	44.5
Cash position is represented by		
Cash	**18.7**	44.3
Cash equivalents	**-**	0.2
	18.7	44.5

Supplementary cash flow information (Note 18)

See accompanying notes

1. DESCRIPTION OF BUSINESS

Nalcor Energy (Nalcor) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the Province) as a Crown corporation and its business includes the development, generation and sale of electricity, oil and gas, industrial fabrication and energy marketing.

Nalcor holds interests in the following subsidiaries and jointly controlled companies:

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province. The principal activity of Hydro is the generation, transmission and sale of electricity. Hydro's operations include both regulated and non-regulated activities.

Churchill Falls (Labrador) Corporation Limited (Churchill Falls) is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW).

Nalcor Energy - Oil and Gas Inc. (Oil and Gas) is incorporated under the Corporations Act of Newfoundland and Labrador. Oil and Gas has a broad mandate to engage in upstream and downstream sectors of the oil and gas industry including exploration, development, production, transportation and processing.

Nalcor Energy – Bull Arm Fabrication Inc. (Bull Arm Fabrication) is incorporated under the Corporations Act of Newfoundland and Labrador. Bull Arm Fabrication is Atlantic Canada's largest industrial fabrication site and has a fully integrated infrastructure to support large scale fabrication and assembly. Its facilities include onshore fabrication halls and shops, a dry-dock and a deepwater site.

Twin Falls Power Corporation (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.

Nalcor also has two inactive subsidiaries, Gull Island Power Corporation (GIPCo) and Lower Churchill Development Corporation (LCDC).

Nalcor and its subsidiaries and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

2. SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PRINCIPLES OF CONSOLIDATION

The Consolidated Financial Statements include the financial statements of Nalcor and its subsidiary companies: Hydro (100% owned), Oil and Gas (100% owned), Bull Arm Fabrication (100% owned), GIPCo (100% owned) and LCDC (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

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

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

Substantially all of Oil and Gas' activities are conducted jointly with others and accordingly these statements reflect only Nalcor's proportionate interest in such activities.

USE OF ESTIMATES

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. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization, property, plant and equipment, the valuation of oil and gas reserves and related depletion and other employee future benefits. 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), and these differences could be material.

RATES AND REGULATIONS

Hydro's revenues from its electrical sales to most customers within the province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2010 - 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the Consolidated Financial Statements are more fully disclosed in Note 6.

CASH AND CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash and cash equivalents and short-term investments consist primarily of Canadian Treasury Bills and Banker's Acceptances (BAs). 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. The short-term investments bear interest rates of 0.74% to 1.24% (2010 – 0.40% to 1.35%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

INVENTORY

Inventory is recorded at the lower of average cost and net realizable value.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment or the fair value of assets contributed. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

Gains and losses on the disposal of property, plant and equipment are recognized in Other income and expense as incurred.

<u>Nalcor, Oil and Gas and Bull Arm Fabrication</u>

Amortization is calculated on a straight-line basis over service lives ranging from four to 30 years.

<u>Hydro</u>

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

Amortization 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%. Amortization on distribution system and 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

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators and conductors.

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

Churchill Falls

Amortization is calculated on a straight-line basis over the following estimated useful lives:

Hydroelectric generation plant	10-101 years
Transmission and terminals	14-74 years
Service facilities and other	3-79 years

CAPITALIZED INTEREST

Interest is charged to construction in progress until the project is complete at rates equivalent to the weighted average cost of debt or the last approved weighted average cost of capital for regulated assets. Capitalized interest cannot exceed actual interest incurred.

IMPAIRMENT OF LONG-LIVED ASSETS

Nalcor reviews the carrying value of its oil and gas properties and development projects at the end of each accounting period.

Nalcor reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

PETROLEUM AND NATURAL GAS PROPERTIES

Nalcor employs the full cost method of accounting for oil and gas interests whereby all costs related to the acquisition, exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical costs, carrying charges of non-producing properties, drilling of productive and non-productive wells, the cost of petroleum and natural gas production equipment and administrative costs directly related to exploration and development activities.

Under the full cost method, capitalized costs, together with estimated future capital costs associated with proved reserves, are depleted and depreciated using the unit-of-production method based on estimated gross proved reserves at future prices and costs as determined by independent reservoir engineers.

Costs of acquiring and evaluating unproved properties and certain costs associated with major development projects are not subject to depletion until proved reserves are attributable to the property, production commences or impairment occurs. The carrying value of petroleum and natural gas properties is assessed annually or as circumstances dictate.

Impairment losses are recognized when the carrying value exceeds the sum of:

- the undiscounted future net cash flows from production of proved reserves based on forecast prices and costs;
- the costs of unproved properties, less impairment; and
- the costs of major development projects, less impairment.

The amount of impairment loss is the amount by which the carrying value exceeds the sum of:

- the fair value of proved and probable reserves; and
- the cost, less impairment, of unproved properties and major development projects.

ASSET RETIREMENT OBLIGATIONS

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through Amortization and depletion. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

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.

Nalcor 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 is amortized over the expected average remaining service life of the employee group.

REVENUE RECOGNITION

Electricity Sales

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. Sales within the province are primarily at rates approved by the PUB, whereas export sales and sales to certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates.

A power contract with Hydro-Quebec dated May 12, 1969 (the Power Contract) provides for the sale of a significant amount of the energy from Churchill Falls until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kWh to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Quebec under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Quebec during the months of November through March in each of the remaining years of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, is tracked over a four-year period and then either recovered from or refunded to Hydro-Quebec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2010 - 7%).

Oil Sales

Revenue from the sale of crude oil is recognized under the accrual method when the significant risks and rewards of ownership have passed and collection is reasonably assured. The transfer of risks and rewards is considered to have occurred when title to the product passes to the customer.

Revenue from properties in which Oil and Gas has an interest with other producers is recognized on the basis of the net working interest using the entitlement method. Under this method, crude oil produced and sold below or above Oil and Gas' net working interest results in an underlift or overlift position. Underlift or overlift positions are measured at market value and recorded as an asset or liability respectively.

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 the date of settlement and 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, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Financial Instruments

Financial assets and financial liabilities are recognized on the balance sheet when Nalcor becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Nalcor has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Nalcor has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Short-term investments	Available for sale
Accounts receivable	Loans and receivables
Derivative assets	Held for trading
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Derivative liabilities	Held for trading
Long-term debt	Other liabilities
Long-term payables	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents, short-term investments, sinking funds – other investments, reserve fund, derivative assets and derivative liabilities which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred through interest and finance charges, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Nalcor to manage market risk. Nalcor's policy is not to utilize derivative instruments for speculative purposes. Nalcor may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Nalcor formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

During the year, Nalcor had foreign exchange forward contracts designated as cash flow hedges (Note 16). In a cash flow hedge relationship, the portion of unrealized gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income. Nalcor had no cash flow hedges in place at December 31, 2011.

Nalcor had no fair value hedges in place at December 31, 2011 or 2010.

FUTURE ACCOUNTING CHANGES – INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In October 2010, the Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2012. Nalcor is a qualifying entity and chose to use the deferral option.

Although IFRS and Canadian GAAP are based on a similar conceptual framework there are a number of differences in recognition, measurement and disclosure. The areas with the highest potential impact on Nalcor are property, plant and equipment, regulatory assets and liabilities and petroleum and natural gas properties.

The International Accounting Standards Board (IASB) has deferred its work on rate-regulated activities accounting project and has not provided interim guidance for the recognition and measurement of regulatory assets and liabilities. Accordingly, Nalcor continues to assess existing IFRS guidance to determine the impact of differences that will apply to accounting for rate-regulated activities upon adoption of IFRS. In December 2011, Hydro applied to the PUB for approval to use IFRS as the basis for regulatory reporting.

Nalcor continues to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion on January 1, 2012 and the accounting elections made.

3. CHANGE IN ESTIMATE

In 2010, Churchill Falls engaged a depreciation specialist to review the service lives of its property, plant and equipment. Based on the analysis performed, the service lives of Churchill Falls' property, plant and equipment were revised effective January 1, 2011. This change is treated as a change in estimate in accordance with CICA Section 1506, "Accounting Changes" and as such has been applied prospectively from January 1, 2011.

4. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	Cost	Contributions In Aid of Construction	Accumulated Amortization	Net Book Value
			2011	
Electric – generation	**1,798.0**	**29.3**	**636.2**	**1,132.5**
Electric – transmission and distribution	**889.7**	**68.2**	**298.4**	**523.1**
Development projects	**337.5**	**-**	**-**	**337.5**
Other	**330.3**	**24.7**	**190.1**	**115.5**
	3,355.5	**122.2**	**1,124.7**	**2,108.6**

(millions of dollars)			2010	
Electric – generation	1,767.6	29.5	615.9	1,122.2
Electric – transmission and distribution	849.0	67.9	280.4	500.7
Development projects	240.1	-	-	240.1
Other	309.4	24.0	179.7	105.7
	3,166.1	121.4	1,076.0	1,968.7

As at December 31, 2011 the cost of assets under construction and therefore excluded from costs subject to amortization was $384.8 million (2010 - $257.7 million).

Included in Development projects is $329.0 million related to the lower Churchill hydroelectric development. On November 18, 2010, a term sheet was executed between Nalcor and Emera Inc. (Emera) to develop Muskrat Falls, a hydroelectric development on the lower Churchill River in Labrador, and related transmission assets. The agreement will result in the development of the 824 MW Muskrat Falls site, with power being transmitted over a new transmission line (the Labrador-Island Transmission Link) to be constructed from Labrador across the Strait of Belle Isle to the Avalon Peninsula on the island of Newfoundland, and the development of a new transmission system (the Maritime Transmission Link) from Newfoundland to Nova Scotia, for the provision of power to Emera in Nova Scotia and the provision of market access to Nalcor. Nalcor will also obtain transmission access in Nova Scotia, New Brunswick and Maine from Emera. The project has a total estimated cost of $6.2 billion (excluding financing costs). Nalcor will own and finance 100% of Muskrat Falls and the Labrador Transmission Assets. Nalcor and Emera, through a partnership in which Nalcor has the majority interest, will finance the Labrador-Island Transmission Link. The Maritime Transmission Link will be 100% owned and financed by Emera. During 2011, Nalcor continued to work towards sanction as well as finalizing commercial agreements with Emera.

5. PETROLEUM AND NATURAL GAS PROPERTIES

(millions of dollars)	2011	2010
Petroleum and natural gas properties	**344.0**	279.8
Less: accumulated depletion	**39.8**	10.6
	304.2	269.2

Internal costs directly related to acquisition, exploration and development activities capitalized in 2011 were $0.5 million (2010 - $0.6 million).

As at December 31, 2011, $139.1 million (2010 - $174.7 million) of accumulated costs of petroleum and natural gas properties were not subject to depletion and depreciation.

Oil and Gas properties include Nalcor's acquisition costs and proportionate share of exploration and development costs. Nalcor has a 4.9% working interest in the Hebron oil field, a 5.0% working interest in the White Rose Growth Project, and a 10% working interest in the Hibernia Southern Extension. Nalcor also has an average working interest of 71% in two onshore exploration permits in Parson's Pond on the Great Northern Peninsula. A third exploration permit in which Nalcor had a 62% interest has expired.

On February 17, 2011, Oil and Gas announced that it will not drill the third of a three well drilling program related to its exploration licenses in Parson's Pond on the West Coast of Newfoundland. The two drilled exploration wells are currently in a suspended state. The costs capitalized for Parson's Pond have been included in the calculation of 2011 depletion.

6. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2011**	2010	Remaining Recovery Settlement Period (years)
Regulatory assets			
Foreign exchange losses	**64.7**	66.8	30.0
Deferred major extraordinary repairs	**0.6**	2.3	0.8
Deferred energy conservation costs	**1.1**	0.6	n/a
Total regulatory assets	**66.4**	69.7	
Less current portion	**2.8**	3.8	
	63.6	65.9	
Regulatory liabilities			
Rate stabilization plan	**170.3**	159.2	n/a
Deferred purchased power savings	**0.6**	0.6	15.5
Total regulatory liabilities	**170.9**	159.8	
Less current portion	**137.6**	118.9	
	33.3	40.9	

Nalcor's subsidiary, Hydro, has operations that are regulated by the PUB.

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. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

RATE STABILIZATION PLAN

On January 1, 1986, Hydro, having received the approval 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 required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent 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. A portion of the RSP balance totalling approximately $100 million has been set aside by the PUB and will be subject to a future regulatory ruling on the allocation between the industrial customers and retail customers. This balance is mainly due to reduced use of the Holyrood Thermal Generating Station (HTGS) leading to fuel savings at the HTGS as a result of the shut down of a portion of the pulp and paper industry in the province since 2007.

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, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2011, $20.9 million was deferred (2010 - $23.3 million recognized) in the RSP and $25.4 million (2010 - $2.3 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuel expenses.

DEFERRED FOREIGN EXCHANGE LOSSES

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. 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, Canadian GAAP 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 40-year period. This amortization, of $2.1 million annually, is included in interest expense (Note 17).

DEFERRED MAJOR EXTRAORDINARY REPAIRS

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 HTGS. This program was carried out over a three-year period. Pursuant to Order No. P.U. 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 were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2011, $1.7 million (2010 - $2.6 million) of amortization was recognized in Operations and administration expense.

DEFERRED ENERGY CONSERVATION COSTS

Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2011, $0.5 million (2010 - $0.4 million) was deferred.

DEFERRED PURCHASED POWER SAVINGS

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30-year period. These savings in the amount of $0.6 million (2010 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

PROPERTY, PLANT AND EQUIPMENT

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 amortized over future periods as part of the total cost of the related asset. In 2011, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.4% and the amount capitalized is lower and interest expense is higher by $0.2 million than that which would be permitted under Canadian GAAP in the absence of rate regulation. In 2010, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.2% and the amount capitalized was higher and interest expense was lower by $0.1 million than that which would be permitted under Canadian GAAP in the absence of rate regulation.

Hydro amortizes 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 amortized using the straight-line method. During 2010, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2009. Based on the results of this study, management currently estimates that switching from the use of sinking fund to straight-line amortization for hydroelectric and transmission assets, as well as changing from unit based amortization to a group based method on a remaining life basis and implementing the recommended service lives, would have resulted in an estimated decrease of $1.0 million in the annual amortization expense. In December 2011, Hydro applied to the PUB requesting approval of these recommended changes. Approval has not yet been received.

7. OTHER LONG-TERM ASSETS

(millions of dollars)		2011	2010
Long-term receivables	(a)	1.6	26.0
Sinking funds	(b)	247.0	208.4
Reserve fund	(c)	45.4	39.3
		294.0	273.7

(a) Included in long-term receivables are two refundable deposits, one in the amount of $1.3 million (2010 - $1.2 million) associated with an application for transmission service into Nova Scotia, bearing interest at the Prime Rate less 1% and a second in the amount of $0.1 million (2010 - $0.1 million) associated with an application for transmission service in New Brunswick, bearing interest at the Prime Rate. During 2011, Hydro-Quebec refunded two deposits totalling $24.1 million associated with applications for transmission service through Quebec. The remaining balance of $0.2 million (2010 - $0.3 million) is the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs.

(b) Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which are intended to be held 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 in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 3.12% to 9.86% (2010 - 3.86% to 9.86%).

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement [Note 20(j)]. A summary of Nalcor's 65.8% share of the reserve fund is as follows:

(millions of dollars)	2011	2010
Opening balance	39.3	34.8
Contribution	5.3	5.3
Net interest	0.1	(0.4)
Mark-to-market adjustment	0.7	(0.4)
Fair value of reserve fund	45.4	39.3

8. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Nalcor's proportionate share of Churchill Falls' assets and liabilities at December 31 and its proportionate interest in Churchill Falls' operations for the year then ended.

(millions of dollars)	**2011**	2010
Current assets	**41.8**	39.2
Long-term assets	**394.8**	375.8
Current liabilities	**19.0**	15.6
Long-term liabilities	**16.2**	14.0
Revenues	**64.2**	74.1
Expenses	**43.1**	50.8
Net income	**21.1**	23.3
Cash provided by (used in)		
Operating activities	**32.3**	48.3
Financing activities	**0.9**	(27.9)
Investing activities	**(32.6)**	(0.4)

Income tax expense in the amount of $0.2 million (2010 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been included in expenses.

9. LONG-TERM DEBT

(millions of dollars)	**2011**	2010
Long-term debt	**1,139.7**	1,144.9
Less current portion	**8.2**	8.2
	1,131.5	1,136.7

NALCOR

In March 2011, Nalcor renegotiated the terms of its credit facility with its banker in order achieve alignment with its revised short-term working capital needs. The facility was converted to a demand operating facility with a limit of $100.0 million, with no change in the financial covenants. Borrowings in Canadian dollars may take the form of Prime Rate Advances, BAs and Letters of Credit. Borrowings in USD may take the form of Base Rate Advances, LIBOR Advances and Letters of Credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate. At year end, the only drawing on the facility was one irrevocable letter of credit issued to the Department of Fisheries and Oceans. This letter of credit, in the amount of $0.3 million [Note 20(g)], was issued in connection with the operation of hydroelectric assets on the Exploits River.

HYDRO

(millions of dollars)	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2011	2010
V *	125.0	10.50	1989	2014	**124.7**	124.6
X *	150.0	10.25	1992	2017	**149.4**	149.3
Y *	300.0	8.40	1996	2026	**293.5**	293.3
AB *	300.0	6.65	2001	2031	**306.5**	306.7
AD *	125.0	5.70	2003	2033	**123.6**	123.6
AE	225.0	4.30	2006	2016	**224.0**	223.8
Total debentures	1,225.0				**1,221.7**	1,221.3
Less: sinking fund investments in own debentures					**82.0**	76.4
					1,139.7	1,144.9
Less: payments due within one year					**8.2**	8.2
					1,131.5	1,136.7

* 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 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity less than ten years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than 10 years. The fee was waived for 2010. The fee for 2011 was $3.9 million.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2011 there were no promissory notes outstanding (2010 - nil).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2010 - nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year end, Hydro had 24 letters of credit outstanding [Note 20(g)] reducing the availability of the credit facility by $18.9 million (2010 - $18.9 million).

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

(millions of dollars)	2012	2013	2014	2015	2016
Sinking fund requirement	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	125.0	-	225.0
	8.2	8.2	133.2	8.2	233.2

CHURCHILL FALLS

Operating Credit Facility

Churchill Falls maintains a $10.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate.

Churchill Falls has issued three irrevocable letters of credit totalling $2.0 million to ensure satisfactory management of its waste management system and compliance with a certificate of approval for the transportation of special and hazardous wastes, granted by the Department of Environment and Conservation [Note 20(g)].

10. ASSET RETIREMENT OBLIGATIONS

(millions of dollars)	2011	2010
Asset retirement obligations, beginning of year	14.8	-
Liabilities incurred	3.7	15.2
Accretion	0.7	0.1
Revisions	5.6	(0.5)
Asset retirement obligations, end of year	24.8	14.8

Nalcor has recognized liabilities associated with the retirement of portions of the HTGS disposal of polychlorinated biphenyls (PCB) and retirement obligations associated with Nalcor's net interest in petroleum and natural gas properties.

The total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2011 are $27.0 million (2010 - $20.5 million). Payments to settle the liability are expected to occur between 2021 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rate of 2.9% (2010 - 4.1%).

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2011 are $3.6 million. Payments to settle the liability are expected to occur between 2012 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Company's credit adjusted risk free rates ranging between 3.1% and 5.6%.

Oil and Gas asset retirement obligations result from net ownership interests in petroleum and natural gas properties and related well sites. The total undiscounted estimated cash flows required to settle the obligations at December 31, 2011 is $8.9 million (2010 -$4.8 million). Payments to settle the liability are expected to occur between 2020 and 2030. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at Nalcor's credit adjusted risk free rates ranging between 5.0% and 6.2% (2010 - 4.7%).

A significant number of Nalcor's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Nalcor'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 Nalcor is legally required to remove, an asset retirement obligation for those assets will be recognized at that time.

11. LONG-TERM PAYABLES

The long-term payables consist of a payable to Hydro-Quebec and a payable to the Innu Nation.

The long-term payable to Hydro-Quebec as at December 31, 2011 represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which is being tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, $0.4 million of the amount is current and is recorded in Accounts payable and accrued liabilities while the remaining $4.8 million (2010 - $4.6 million) is long-term. The final amount will be determined on August 31, 2012 and will be paid or collected monthly beginning September 2012 and ending August 2016.

The long-term payable to the Innu Nation relates to the Upper Churchill Redress Agreement that was ratified in November 2011. Under this agreement, Nalcor is required to pay, to the Innu Nation, $2.0 million annually escalated by 2.5% until 2041. Currently, $2.0 million of the amount is current and is recorded in Accounts payable and accrued liabilities while the remaining $37.9 million is long-term. Nalcor has also recorded funding receivable from the Province in relation to the Upper Churchill Redress Agreement as outlined in Note 21(p).

12. EMPLOYEE FUTURE BENEFITS

PENSION PLAN

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $6.4 million (2010 - $5.8 million) are expensed as incurred.

OTHER BENEFITS

Nalcor 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. In 2011, cash payments to beneficiaries for its unfunded other employee future benefits was $2.6 million (2010 - $2.4 million). The most recent actuarial valuation was performed as at December 31, 2009 and extrapolated to December 31, 2011. The next actuarial valuation will be performed as at December 31, 2012.

(millions of dollars)	2011	2010
Accrued benefit obligation		
Balance at beginning of year	87.5	72.7
Current service cost	3.3	2.6
Interest cost	5.1	4.8
Actuarial loss	21.0	9.8
Benefits paid	(2.6)	(2.4)
Balance at end of year	114.3	87.5
Plan deficit	114.3	87.5
Unamortized actuarial loss	(46.5)	(27.0)
Unamortized past-service cost	(0.2)	(0.2)
Accrued benefit liability at end of year	67.6	60.3

(millions of dollars)	2011	2010
Component of benefit cost		
Current service cost	3.3	2.6
Interest cost	5.1	4.8
Actuarial loss	21.0	9.8
	29.4	17.2
Difference between actuarial loss and amount recognized	(19.5)	(8.9)
Benefit expense	9.9	8.3

The significant actuarial assumptions used in measuring the accrued benefit obligations and benefit expense are as follows:

	2011	2010
Discount rate – benefit cost	5.75%	6.50%
Discount rate – accrued benefit obligation	4.55%	5.75%
Rate of compensation increase	3.50%	3.50%

Assumed healthcare trend rates:

	2011	2010
Initial health care expense trend rate	7.50%	7.50%
Cost trend decline to	5.00%	5.00%
Year that rate reaches the rate it is assumed to remain at	2016	2016

A 1% change in assumed health care trend rates would have had the following effects:

Increase	2011	2010
Current service and interest cost	1.7	1.3
Accrued benefit obligation	23.1	15.1
Decrease	2011	2010
Current service and interest cost	(1.3)	(1.0)
Accrued benefit obligation	(17.6)	(11.7)

13. SHAREHOLDER'S EQUITY

SHARE CAPITAL

(millions of dollars)	2011	2010
Common shares of par value $1 each		
Authorized: unlimited		
Issued and outstanding 122,500,000 (2010 – 122,500,000)	122.5	122.5

CONTRIBUTED CAPITAL

(millions of dollars)	2011	2010
Total contributed capital	390.5	374.1

On February 3, 2010, the Province established the Churchill Falls (Labrador) Corporation Trust (the Trust) with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. During 2011, the Province contributed capital in the amount of $16.0 million (2010 - $40.0 million) and the Trust contributed $0.4 million (2010 - $0.6 million).

14. ACCUMULATED OTHER COMPREHENSIVE INCOME

(millions of dollars)	2011	2010
Balance, beginning of year	27.3	22.0
Change in fair value of available for sale financial instruments	31.6	20.6
Change in fair value of derivatives designated as cash flow hedges	0.1	1.1
Amount recognized in net income	(12.6)	(16.4)
Balance, end of year	46.4	27.3

15. CAPITAL MANAGEMENT

Nalcor's primary objectives when managing capital are to minimize its cost of capital within the confines of established risk parameters, and to safeguard Nalcor's ability to continue as a going concern. Nalcor's approach to capital management is performed on a consolidated basis. Management monitors the capital requirement for each subsidiary individually.

The capital managed by Nalcor is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

A summary of the capital structure is outlined below:

(millions of dollars)	2011		2010	
Debt				
Long-term debt	1,131.5		1,136.7	
Current portion of long-term debt	8.2		8.2	
Sinking funds	(247.0)		(208.4)	
	892.7	38.5%	936.5	42.5%
Equity				
Share capital	122.5		122.5	
Contributed capital	390.5		374.1	
Accumulated other comprehensive income	46.4		27.3	
Retained earnings	868.2		741.5	
	1,427.6	61.5%	1,265.4	57.5%
Total debt and equity	2,320.3	100.0%	2,201.9	100.0%

Nalcor's unsecured demand operating facility has covenants restricting the issuance of debt such that the unconsolidated debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the Debt Service Coverage Ratio should at all times be greater than 1.5 to 1.0 on an unconsolidated basis. As at December 31, 2011, Nalcor was in compliance with these covenants.

HYDRO

Hydro's principal business requires ongoing access to capital in order to maintain the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost.

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes (EBIT) coverage of interest.

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% common equity is maintained, a ratio which management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of the PUB.

Legislation stipulates that the total of the short-term loans issued by Hydro and outstanding at any time, shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300 million. There was no balance outstanding as at December 31, 2011 or 2010. Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

CHURCHILL FALLS

Churchill Falls' objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls' requirements for capital in the future are expected to increase, coincident with the aging of the plant and related infrastructure and the execution of the long-term asset management plan. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of Churchill Falls is comprised entirely of equity capital (share capital, contributed capital and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

OIL AND GAS

The capital managed by Oil and Gas is composed of share capital, contributed capital and retained earnings. Oil and Gas' objective, when managing capital, is to maintain its ability to continue as a going concern. Oil and Gas' future requirements for capital are expected to increase, coincident with the increase in development projects. This increased demand for capital is expected to be temporary and will abate as projects under development move into the production stage. Due to the temporary nature of the capital requirement, these requirements will be funded entirely through contributed capital as well as internal cash flows. A balanced approach to dividends will ensure maximum return to the shareholder while ensuring liquidity levels adequate to address normal business risk.

Future requirements for capital are expected to increase to fund Oil and Gas' share of project development costs. Capital costs to date have been financed by equity. As projects reach the production stage, Cash flow generated from operations contributes toward funding its capital requirements by reducing the reliance on Nalcor to finance growth.

BULL ARM FABRICATION

Bull Arm Fabrication's objective when managing capital is to maintain its ability to continue as a going concern. The focus of the capital management policy is to ensure the availability of sufficient cash to satisfy capital requirements.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

FAIR VALUE

The estimated fair values of financial instruments as at December 31, 2011 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Nalcor might receive or incur in actual market transactions.

As a significant number of Nalcor's assets and liabilities do not meet the definition of a financial instrument, the fair value estimates below do not reflect the fair value of Nalcor as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
(millions of dollars)	2011		2010	
Financial assets				
Cash and cash equivalents	**18.7**	**18.7**	44.5	44.5
Short-term investments	**16.9**	**16.9**	15.7	15.7
Accounts receivable	**163.6**	**163.6**	93.6	93.6
Derivative assets	**0.2**	**0.2**	2.0	2.0
Sinking funds – investments in same Hydro issue	**82.0**	**103.7**	76.4	93.6
Sinking funds – other investments	**247.0**	**247.0**	208.4	208.4
Reserve fund	**45.4**	**45.4**	39.3	39.3
Long-term receivable[(1)]	**1.6**	**n/a**	26.0	n/a
Financial liabilities				
Accounts payable and accrued liabilities	**156.1**	**156.1**	152.1	152.1
Derivative liabilities	**0.2**	**0.2**	0.3	0.3
Long-term debt including amount due within one year (before sinking funds)	**1,221.7**	**1,695.3**	1,221.3	1,589.7
Long-term payables	**42.7**	**43.2**	4.6	4.7

The fair value of cash and cash equivalents, short-term investments, accounts receivable and accounts payable and accrued liabilities approximates their carrying values due to their short-term maturity.

(1) The fair value of the long-term receivable subject to uncertainty regarding the timing of future cash flows and as such, the fair value of the long-term receivable could not be determined as at December 31, 2011 and 2010.

<u>Establishing Fair Value</u>

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents Nalcor's fair value hierarchy for financial assets and liabilities as at December 31. There were no transfers between Level 1 and Level 2 during the year:

	Level 1	Level 2	Total
(millions of dollars)		**2011**	
Financial assets			
Cash and cash equivalents	**18.7**	**-**	**18.7**
Short-term investments	**16.9**	**-**	**16.9**
Accounts receivable	**163.6**	**-**	**163.6**
Derivative assets	**-**	**0.2**	**0.2**
Sinking funds – investments in same Hydro issue	**-**	**103.7**	**103.7**
Sinking funds – other investments	**-**	**247.0**	**247.0**
Reserve fund	**-**	**45.4**	**45.4**
Financial liabilities			
Accounts payable and accrued liabilities	**156.1**	**-**	**156.1**
Derivative liabilities	**-**	**0.2**	**0.2**
Long-term debt including amount			
due within one year (before sinking funds)	**-**	**1,695.3**	**1,695.3**
Long-term payables	**-**	**43.2**	**43.2**
		2010	
Financial assets			
Cash and cash equivalents	44.5	-	44.5
Short-term investments	15.7	-	15.7
Accounts receivable	93.6	-	93.6
Derivative assets	-	2.0	2.0
Sinking funds – investments in same Hydro issue	-	93.6	93.6
Sinking funds – other investments	-	208.4	208.4
Reserve fund	-	39.3	39.3
Financial liabilities			
Accounts payable and accrued liabilities	152.1	-	152.1
Derivative liabilities	-	0.3	0.3
Long-term debt including amount			
due within one year (before sinking funds)	-	1,589.7	1,589.7
Long-term payables	-	4.7	4.7

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2011 and 2010.

RISK MANAGEMENT

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Nalcor's business.

Credit Risk

Nalcor is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Nalcor will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments arise in the normal course of business and do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Nalcor manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers. As at December 31, 2011 security deposits of $0.7 million (2010 - $0.1 million) are included in accounts payable and accrued liabilities.

Nalcor's three largest customers account for 72.3% (2010 - 78.3%) of total energy sales and 63.4% (2010 - 59.6%) of accounts receivable. These customers are comprised of rate regulated entities or organizations with investment grade credit ratings.

Nalcor does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2011.

Nalcor manages its investment credit risk exposure by restricting its investments to high-quality securities such as Canada Treasury Bills, provincial Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks. Additionally, the investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution with the exception of the Government of Canada.

Liquidity Risk

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows.

Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and credit facilities.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues, with the exception of Series AE.

The following are the contractual maturities of Nalcor's financial liabilities, including principal and interest, as at December 31, 2011:

(millions of dollars)	<1 Year	1-3 Years	3-5 Years	>5 Years	Total
Accounts payable and accrued liabilities	156.1	-	-	-	156.1
Derivative liabilities	0.2	-	-	-	0.2
Long-term debt including amount due within one year	-	125.0	225.0	875.0	1,225.0
Long-term payables	-	6.9	6.7	78.3	91.9
Interest	61.9	174.2	152.7	649.2	1,038.0
	218.2	306.1	384.4	1,602.5	2,511.2

Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. Nalcor has a formal financial risk management policy that outlines the risks associated with the operations of Nalcor and its subsidiaries and guidelines to be followed in the management of those risks. This policy is reviewed by Nalcor's Board of Directors annually or more frequently if there is a material change to Nalcor's financial risks. The Audit Committee of the Board provides oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates

Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Nalcor attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Nalcor is exposed to interest rate risk related to the short-term debt portfolio, the sinking fund investment portfolios and reserve fund investment portfolios. Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

The following table illustrates Nalcor's exposure to a 50 basis points (0.5%) change in interest rates:

	Net Income		Other Comprehensive Income	
(millions of dollars)	0.5% decrease	0.5% increase	0.5% decrease	0.5% increase
Interest on short-term investments	(0.1)	0.1	-	-
Interest on sinking fund	-	-	20.0	(2.7)
Interest on reserve fund	-	-	1.0	(1.0)
	(0.1)	0.1	21.0	(3.7)

Foreign Currency and Commodity Exposure

The fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Nalcor's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS, certain electricity sales and oil sales which are denominated in USD.

During 2011, Hydro had total purchases of No. 6 fuel of $135.1 million (2010 - $104.1 million) denominated in USD. Exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in fuel prices including exchange rates, as compared to that approved in Hydro's most recent cost of service study, are captured in the RSP and are either refunded to, or collected from, customers through rate adjustments. Hydro also employs the periodic use of forward currency contracts to manage exposure to exchange rates on a particular day.

During 2011, total electricity sales denominated in USD were $67.9 million (2010 - $72.8 million). In 2011 Hydro mitigated this risk through the use of commodity swaps and foreign currency forward contracts.

During 2011, total oil energy sales denominated in USD were $90.4 million (2010 - $15.2 million). Oil and Gas has sales denominated in USD that are based on prevailing market oil prices. Market risk associated with fluctuations in oil prices and foreign exchange rates is managed consistent with Nalcor's financial risk management policy. Oil and Gas has exposure to fluctuations in the USD/CAD exchange rate based on its sales, which are denominated in USD. However, a significant portion of Oil and Gas' planned capital expenditures are denominated in USD, which mitigates this exposure. Oil and gas also mitigates its commodity risk exposure through the use of commodity swaps.

During 2009, Hydro entered into a series of 24 monthly foreign exchange forward contracts with a notional value of $87.9 million USD to hedge foreign exchange risk on 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of $1.17 CAD per USD. These contracts were designated as part of a hedging relationship. The last of these contracts expired in April 2011.

During 2011, Hydro entered into a series of nine monthly foreign exchange forward contracts with a notional value of $35.7 million USD to hedge foreign exchange risk on 75% of Hydro's USD electricity sales. These contracts had an average exchange rate of $1.00 CAD per USD.

In 2011, Hydro also entered into 20 commodity swap contracts with a notional value of $27.8 million USD to hedge commodity price risk on electricity sales. These contracts swapped floating market rates for fixed rates, with Hydro receiving an average fixed rate of $35.37 USD/MWh (2010 - $36.01 USD/MWh). During 2011, $1.9 million in losses from these contracts were included in Other income and expense (2010 - $3.4 million).

In February 2011, Oil and Gas entered into 11 commodity swap contracts with a notional value of $17.4 million USD to hedge a portion of its commodity price risk on sales. In exchange for paying the market rate over the term of the contract, Oil and Gas received an average fixed price of $100.53 USD/BBL. These contracts have not been designated as part of a hedging relationship. During 2011, $2.0 million in losses from these contracts were included in Other income and expense.

EFFECT OF HEDGE ACCOUNTING ON FINANCIAL STATEMENTS

	Net Gains Included in Net Income	Unrealized Gains Included in OCI	Net Gains Included in Net Income	Unrealized Gains Included in OCI
(millions of dollars)	**2011**		2010	
Ineffective portion	**(0.1)**	**-**	0.2	-
Effective portion	**1.5**	**-**	5.9	1.3

The ineffective portion of hedging gains and losses is included in net income through Other income and expense.

17. INTEREST AND FINANCE INCOME/CHARGES

(millions of dollars)	**2011**	2010
Interest and finance income		
Interest on sinking fund	**16.6**	15.2
Interest on reserve fund	**1.5**	1.4
Other interest income	**2.1**	1.4
	20.2	18.0
Interest and finance charges		
Long-term debt	**90.5**	91.7
Interest on rate stabilization plan	**12.2**	10.2
Accretion of long-term debt	**0.5**	0.4
Amortization of deferred foreign exchange losses	**2.1**	2.1
Debt guarantee fee	**3.9**	-
Other	**0.7**	1.9
	109.9	106.3
Interest capitalized during construction	**(1.5)**	(1.2)
	108.4	105.1

18. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	2011	2010
Accounts receivable	(70.0)	(4.7)
Inventory	(0.5)	(3.5)
Prepaid expenses	(0.1)	(1.4)
Regulatory assets	3.3	4.4
Regulatory liabilities	11.1	37.2
Accounts payable and accrued liabilities	4.0	26.9
Employee future benefits	7.3	5.9
Changes in non-cash working capital balances	(44.9)	64.8
Income taxes paid	0.2	0.2
Interest received	2.5	2.2
Interest paid	90.9	92.4

19. SEGMENT INFORMATION

Nalcor operates in five business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Quebec. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. Energy Marketing activities include the sale of electricity to markets outside the province. Other encompasses industrial fabrication, some non-regulated electricity sales, development activities including the lower Churchill hydroelectric development and corporate activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those described in Note 2.

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Other	Inter-Segment	Total
(millions of dollars)				**2011**			
Revenue							
Energy sales	**469.2**	**66.2**	**88.5**	**69.7**	**5.9**	**(3.9)**	**695.6**
Interest and finance income	**17.6**	**1.7**	**0.1**	**0.6**	**0.7**	**(0.5)**	**20.2**
Other revenue	**2.3**	**0.3**	**3.5**	**-**	**4.7**	**3.3**	**14.1**
	489.1	**68.2**	**92.1**	**70.3**	**11.3**	**(1.1)**	**729.9**
Expenses							
Fuels	**156.7**	**-**	**-**	**-**	**-**	**-**	**156.7**
Power purchased	**52.2**	**-**	**-**	**4.6**	**-**	**(3.9)**	**52.9**
Operations and administration	**104.2**	**41.8**	**21.4**	**20.6**	**11.9**	**-**	**199.9**
Interest and finance charges	**108.4**	**0.3**	**-**	**-**	**0.2**	**(0.5)**	**108.4**
Amortization	**45.7**	**12.2**	**29.6**	**-**	**0.2**	**-**	**87.7**
Other income and expense	**0.9**	**(7.2)**	**2.0**	**1.8**	**0.1**	**-**	**(2.4)**
	468.1	**47.1**	**53.0**	**27.0**	**12.4**	**(4.4)**	**603.2**
Net income (loss) from operations	**21.0**	**21.1**	**39.1**	**43.3**	**(1.1)**	**3.3**	**126.7**
Preferred dividends	**-**	**3.3**	**-**	**-**	**-**	**(3.3)**	**-**
Net income (loss)	**21.0**	**24.4**	**39.1**	**43.3**	**(1.1)**	**-**	**126.7**
Capital expenditures	**63.1**	**25.6**	**63.3**	**-**	**102.6**	**-**	**254.6**
Total assets	**1,866.6**	**436.6**	**329.5**	**3.9**	**454.4**	**(50.1)**	**3,040.9**

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Other	Inter-Segment	Total
(millions of dollars)				2010			
Revenue							
Energy sales	417.1	76.0	15.3	77.5	6.8	(3.9)	588.8
Interest and finance income	16.1	1.7	-	-	0.5	(0.3)	18.0
Other revenue	2.3	0.3	3.9	-	3.3	3.5	13.3
	435.5	78.0	19.2	77.5	10.6	(0.7)	620.1
Expenses							
Fuels	140.3	-	-	-	0.1	-	140.4
Power purchased	44.2	-	-	4.1	-	(3.9)	44.4
Operations and administration	97.1	40.5	10.7	21.4	12.2	-	181.9
Interest and finance charges	102.9	1.6	0.1	0.5	0.3	(0.3)	105.1
Amortization	43.8	12.6	10.9	-	0.2	-	67.5
Other income and expense	0.7	-	-	2.6	-	-	3.3
	429.0	54.7	21.7	28.6	12.8	(4.2)	542.6
Net income (loss) from operations	6.5	23.3	(2.5)	48.9	(2.2)	3.5	77.5
Preferred dividends	-	3.5	-	-	-	(3.5)	-
Net income (loss)	6.5	26.8	(2.5)	48.9	(2.2)	-	77.5
Capital expenditures	55.5	9.9	82.8	-	48.1	-	196.3
Total assets	1,831.5	417.0	278.3	7.4	324.7	(54.1)	2,804.8

GEOGRAPHIC INFORMATION

Revenues by geographic area:

(millions of dollars)	2011	2010
Newfoundland and Labrador	**599.6**	476.4
Quebec	**62.1**	71.9
New Brunswick	**56.7**	60.7
Nova Scotia	**11.5**	11.1
	729.9	620.1

All of Nalcor's physical assets are located in the province.

20. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls 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 costs associated with making the plant operational, if required, are not estimable at this time. Beginning in 2015, Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

(b) 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 that further monitoring be carried out. Monitoring was performed throughout 2010 with no remediation required. However, the 2010 sampling did indicate some increase in PCB concentrations in sediment and fish flesh in specific locations, and an increased frequency of monitoring was recommended. Further sampling has now been scheduled for 2013.

(c) Hydro entered into power sales agreements with third parties. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Quebec TransEnergie to acquire access to 265 MW of transmission capacity from Labrador through Quebec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Quebec TransEnergie, the transmission rental payments to contract maturity are as follows:

2012	$19.0 million
2013	$19.0 million
2014	$4.8 million

(d) Nalcor and its subsidiaries have received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Nalcor's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.4 million (2010 - $0.1 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2010 - $21.8 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action is not determinable at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately $54.0 million (2010 - $41.6 million). In addition, Oil and Gas has committed to fund its share of all exploration and development projects.

(f) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

Estimated payments due in each of the next five years are as follows:

(millions of dollars)	2012	2013	2014	2015	2016
Power purchases	24.8	25.5	26.1	26.8	27.3

(g) Nalcor has issued an irrevocable letter of credit, in the amount of $0.3 million, to the Department of Fisheries and Oceans. This letter of credit was issued connection with the operation of the hydroelectric assets on the Exploits River.

Hydro has issued 23 irrevocable letters of credit to the New Brunswick System Operator totaling $18.6 million as credit support related to applications for point to point transmission services. In addition Hydro has issued one letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

Churchill Falls has issued three irrevocable letters of credit, totaling $2.0 million, to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes granted by the Department of Environment and Conservation.

Oil and Gas has issued two irrevocable letters of credit, totaling $4.7 million, to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

(h) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency in relation to a Wind-Hydrogen-Diesel research and development project. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2011 there have been no commercial implementations.

(i) On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The trial is scheduled for the fall of 2013. The outcome of this motion is not determinable at this time.

(j) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested $17.0 million in each of 2007, 2008 and 2009, and $8.0 million in 2010 and 2011. The remaining investments were acquired in January 2012.

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Banks. Nalcor's share of this commitment is 65.8%.

21. RELATED PARTY TRANSACTIONS

Nalcor enters into various transactions with its parents, subsidiaries and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which Nalcor transacts are as follows:

Related Party	Relationship
The Province	100% shareholder of Nalcor Energy.
Churchill Falls	Jointly controlled subsidiary of Hydro.
Twin Falls	Jointly controlled subsidiary of Churchill Falls.
The Trust	Created by the Province with Churchill Falls as the beneficiary.
Board of Commissioners of Public Utilities (PUB)	Agency of the Province.

Intercompany transactions and balances have been eliminated upon consolidation. The amounts included in the financial statements for related party transactions are as follows:

		The Province	Other Affiliates	Total
(millions of dollars)			2011	
Revenue	(e)(f)(g)(h)(o)(q)	**4.2**	**-**	**4.2**
Expenses	(b)(c)(d)(i)(j)(k)(l)(n)(p)	**(18.0)**	**1.9**	**(16.1)**
Accounts receivable	(c)(e)(o)(p)	**40.5**	**0.6**	**41.1**
Accounts payable and accrued liabilities	(b)(d)(i)(j)(k)(l)(n)	**19.4**	**0.6**	**20.0**
Deferred credits	(f)(g)(h)(m)	**10.4**	**-**	**10.4**
(millions of dollars)			2010	
Revenue	(e)(f)(g)(h)(o)(q)	7.1	-	7.1
Expenses	(b)(c)(d)(i)(j)(k)(l)(n)	16.3	1.3	17.6
Accounts receivable	(c)(e)(o)	0.9	1.8	2.7
Accounts payable and accrued liabilities	(b)(d)(i)(j)(k)(l)(n)	10.5	0.1	10.6
Deferred credits	(f)(g)(h)(m)	2.5	-	2.5

(a) On January 19, 2011, the PUB issued Board Order No. P.U. 1 (2011) approving a modification to the RSP rules to reduce the balance owing to industrial customers by $10.0 million. The order also approved Hydro's reimbursement of the amount to the Province. The payment was made to the Province on January 27, 2011.

(b) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.0 million (2010 - $6.0 million) of the power produced by Churchill Falls.

(c) For the year ended December 31, 2011, approximately $4.1 million (2010 - $3.7 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. At December 31, 2011, $0.5 million (2010 - $1.7 million) was receivable from Churchill Falls.

(d) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2011, Hydro incurred $1.2 million in costs related to the PUB (2010 - $0.6 million) of which $0.6 million (2010 - $0.1 million) was included in Accounts payable and accrued liabilities.

(e) During 2011, Hydro received $0.4 million (2010 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.7 million (2010 - $1.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.3 million (2010 - $0.3 million) recorded as Accounts receivable at year end.

(f) During 2010, Bull Arm Fabrication received $1.0 million from the Province. As at December 31, 2010, $0.3 million was included in Deferred credits. No amount remains in Deferred credits at December 31, 2011.

(g) The Petroleum Exploration Enhancement Program (PEEP) was established as part of the Newfoundland and Labrador Energy Plan. PEEP is designed to boost new petroleum exploration in Western Newfoundland through the acquisition and assessment of seismic data. Funding for PEEP is provided by the Province and the program is administered by Oil and Gas. Total funding available under PEEP is $5.0 million over five years. As at December 31, 2011, $4.5 million of funds have been received (2010 - $1.0 million) and $2.5 million is included in Deferred credits (2010 - $0.6 million receivable).

(h) The Offshore Geoscience Data Project (OGDP) was established as part of the Newfoundland and Labrador Energy Plan. OGDP is designed to boost new offshore petroleum exploration in Newfoundland through the acquisition and assessment of seismic data. Funding for OGDP is provided by the Province and the program is administered by Oil and Gas. Total funding available under OGDP is $20.0 million over two years. As at December 31, 2011, $10.5 million has been received from the Province (2010 - $5.0 million) of which $4.4 million has been recorded in Deferred credits (2010 - $2.1 million).

(i) On February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, $1.4 million (2010 -$0.8 million) has been received and $0.2 million (2010 - $0.2 million) has been accrued as due from the Trust.

(j) Prior to January 1, 2009, the Provincial Minister of Finance was authorized to invest any surplus from Bull Arm Fabrication's operations. Each year, the surplus or deficit from operations was credited or charged to the distribution payable to the Province, however, there are no set terms of payment. The balance contains the accumulated results of operations of Bull Arm Fabrication since inception up to January 1, 2009, less any distributions paid to the Province. Effective January 1, 2009, earnings are to be retained and are reported as retained earnings. As at December 31, 2011, $0.8 million (2010 - $0.8 million) of distributions payable to the Province are included in Accounts payable and accrued liabilities. Bull Arm Fabrication also has a payable to the Province of $0.3 million (2010 - $0.3 million) related to costs incurred prior to the transfer of Bull Arm Fabrication to Nalcor.

(k) Nalcor, as the operator of the Exploits assets, has a net payable to the Province of $9.9 million (2010 - $5.7 million) which is included in Accounts payable and accrued liabilities. Nalcor operates these assets on behalf of the Province on a cost recovery basis.

(l) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2011, $5.3 million (2010 - $5.6 million) was payable.

(m) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2011, $3.5 million (2010 - $0.1 million) has been recorded in Deferred credits.

(n) During 2011, Hydro incurred a debt guarantee fee from the Province of $3.9 million (2010 - nil). This amount remains payable at December 31, 2011.

(o) Hydro has a receivable owing from the Department of Natural Resources of $0.3 million (2010 - nil) related to a Coastal Labrador Efficiency Project established as part of energy conservation activities.

(p) In relation to Nalcor's financial obligations with respect to the Upper Churchill Redress Agreement (Note 11), the Province has agreed to provide funding in the amount of $39.9 million which is recognized in Accounts receivable. As this funding will be used to offset payments to the Innu Nation, the $39.9 million has been netted against the expenses related to Nalcor's obligation under the Upper Churchill Redress Agreement.

(q) Oil and Gas pays royalties on production from its petroleum and natural gas properties to the Province. During 2011, Oil and Gas recognized royalty expense of $1.6 million (2010 - $0.1 million). As at December 31, 2011, $1.0 million (2010 - nil) was included in Accounts payable and accrued liabilities.

22. COMPARATIVE FIGURES

The comparative figures have been reclassified to conform with the 2011 financial statement presentation including Accounts receivable, Long-term receivables, Operating costs and Other income and expense.

FINANCIAL STATISTICS

Years ended December 31 (millions of dollars)	**2011**	2010	2009	2008	2007
OPERATING RESULTS					
Revenue					
Energy sales	**695.6**	588.8	561.6	563.3	567.5
Interest and finance income	**20.2**	18.0	18.2	27.5	21.6
Other	**14.1**	13.3	10.3	7.0	5.9
	729.9	620.1	590.1	597.8	595.0
Expenses					
Fuels and power purchased	**209.6**	184.8	202.3	205.8	197.6
Operations and administration	**199.9**	181.9	171.3	148.2	143.1
Interest and finance charges	**108.4**	105.1	102.3	105.7	122.0
Amortization and depletion	**87.7**	67.5	54.9	53.2	50.7
Other income and expense	**(2.4)**	3.3	(0.7)	-	-
Write down of assets	**-**	-	-	2.7	-
	603.2	542.6	530.1	515.6	513.4
Net Income	**126.7**	77.5	60.0	82.2	81.6
Contributions to net income					
Regulated Electricity	**21.0**	6.5	17.9	9.0	2.9
Energy Marketing	**43.3**	48.9	34.0	47.8	49.9
Churchill Falls	**24.4**	26.8	11.7	20.8	25.1
Oil and Gas	**39.1**	(2.5)	(2.4)	(0.1)	-
Other	**(1.1)**	(2.2)	(1.2)	4.7	3.7
FINANCIAL POSITION					
Total current assets	**270.5**	227.3	225.4	210.9	187.5
Total current liabilities	**313.4**	282.1	255.6	280.0	355.3
Net working capital	**(42.9)**	(54.8)	(30.2)	(69.1)	(167.8)
Property, plant and equipment	**3,233.3**	3,044.7	2,927.2	2,848.5	2,764.7
Accumulated depreciation	**1,124.7**	1,076.0	1,025.5	985.1	939.0
Property, plant and equipment, net	**2,108.6**	1,968.7	1,901.7	1,863.4	1,825.7
Petroleum and natural gas properties	**304.2**	269.2	193.8	112.1	-
Sinking funds	**247.0**	208.4	179.6	163.9	151.8
Other assets	**110.6**	131.2	130.2	124.7	121.3
Long-term debt	**1,131.5**	1,136.7	1,141.6	1,175.7	1,187.8
Other liabilities	**168.4**	120.6	91.5	84.8	65.4
Shareholder's equity	**1,427.6**	1,265.4	1,142.0	934.5	677.8
CAPITAL EXPENDITURES	**254.6**	196.3	178.1	205.5	86.5

STAFFING LEVELS					
Full-time equivalents	**1,290**	1,263	1,241	1,185	1,173

OPERATING STATISTICS

Years ended December 31	**2011**	2010	2009	2008	2007
INSTALLED GENERATING CAPACITY (rated megawatts)					
Churchill Falls	**5,428**	5,428	5,428	5,428	5,428
Twin Falls	**225**	225	225	225	225
NL Hydro					
Hydraulic	**939**	939	939	939	939
Thermal	**632**	640	640	640	640
Diesel	**55**	58	58	56	56
Menihek	**19**	19	19	19	19
Total	**7,298**	7,309	7,309	7,307	7,307
ELECTRIC ENERGY GENERATED, NET (gigawatt hours GWh)					
Churchill Falls	**33,321**	33,781	30,361	34,847	33,254
Hydro					
Hydraulic	**4,512**	4,274	4,200	4,772	4,689
Thermal	**873**	792	930	1,071	1,243
Diesel	**47**	43	46	47	43
Menihek	**42**	37	40	41	13
Total	**38,796**	38,927	35,577	40,778	39,242
ELECTRIC ENERGY SALES (GWh)					
Churchill Falls Export	**28,569**	28,966	25,870	30,007	28,566
NL Hydro					
Utility	**5,317**	5,016	5,108	4,960	4,991
Rural	**949**	884	931	909	888
Industrial	**491**	729	576	1,124	1,136
Export	**1,594**	1,457	1,575	1,393	1,489
Menihek Export	**42**	37	40	41	13
Twin Falls Industrial	**1,715**	1,772	1,591	1,801	1,678
Total	**38,678**	38,861	35,691	40,236	38,762
TRANSMISSION LINES (kilometres)					
Churchill Falls					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,608**	1,608	1,608	1,608	1,608
138 kV	**1,500**	1,500	1,500	1,500	1,500
69 kV	**634**	634	634	634	634
Menihek					
69 kV	**39**	39	39	39	39
Total	**4,820**	4,820	4,820	4,820	
PEAK ELECTRICITY DEMAND (megawatts)					
Churchill Falls	**5,635**	5,604	5,515	4,501	5,575
Hydro System	**1,399**	1,305	1,390	1,323	1,323
PETROLEUM AND NATURAL GAS PROPERTIES					
Oil Production (Thousands Barrels of Oil Equivalent (BOE)/day)					
White Rose Growth Lands	**1.81**	0.51	-	-	-
Hibernia Southern Extension	**0.38**				
Remaining Reserves (Proven and Probable) (Millions BOE)					
White Rose Growth	**4.15**	4.77	5.45	-	-
Hibernia Southern Extension	**18.18**	17.95	-	-	-
Hebron	**30.38**				

NALCOR ENERGY EXECUTIVE LEADERSHIP TEAM

Ed Martin
President & Chief Executive Officer

Gilbert Bennett
Vice President
Lower Churchill Project

Dawn Dalley
Vice President
Corporate Relations

Jim Haynes
Vice President
Regulated Operations Newfoundland and Labrador Hydro

Jim Keating
Vice President
Oil and Gas

Chris Kieley
Vice President
Strategic Planning & Business Development

John MacIsaac
Vice President
Project Execution & Technical Services

Andy MacNeill
Vice President & General Manager
Churchill Falls

Gerard McDonald
Vice President
Human Resources & Organizational Effectiveness

Derrick Sturge
Vice President
Finance & Chief Financial Officer

NALCOR ENERGY BOARD OF DIRECTORS

Tom Clift [1, 3, 4]
Professor
Memorial University - Faculty of Business

Ken Marshall [1, 2]
President
Rogers Cable - Atlantic Region

Cathy Bennett (Interim Chair) [1, 3, 4]
CEO
Bennett Group of Companies

Gerald Shortall [2, 3]
Chartered Accountant
Corporate Director

Ed Martin
President & CEO
Nalcor Energy

[1] Compensation Committee [2] Audit Committee [3] Corporate Governance Committee [4] Safety, Health and Environment Committee

NALCOR ENERGY OFFICERS

Cathy Bennett
Interim Chair

Ed Martin
President & Chief Executive Officer

Derrick Sturge
Vice President
Finance & Chief Financial Officer

Gilbert Bennett
Vice President
Lower Churchill Project

Wayne Chamberlain
General Counsel & Corporate Secretary

Dawn Dalley
Vice President
Corporate Relations

Peter Hickman
Assistant Corporate Secretary

Rob Hull
General Manager, Commercial/Financing

Jim Keating
Vice President
Oil and Gas

Chris Kieley
Vice President
Strategic Planning & Business Development

Kent Legge
General Manager, Finance & Corporate Services

John MacIsaac
Vice President
Project Execution & Technical Services

Gerard McDonald
Vice President
Human Resources & Organizational Effectiveness

CORPORATE GOVERNANCE

BOARD OF DIRECTORS

Nalcor Energy's Board of Directors is comprised of five members, including the Chair of the Board and the President and CEO of Nalcor Energy. The Board, chaired in the interim by Cathy Bennett, has four active committees: Audit, Corporate Governance, Compensation, and Safety, Health and Environment.

The principal functions of the Board include:

(a) developing Nalcor's approach to corporate governance;
(b) reviewing and approving the business, financial, strategic and other plans to enable Nalcor to execute its strategy;
(c) adopting processes for monitoring the company's progress toward its strategic and operational goals;
(d) approving the audited financial statements and Management's Discussion and Analysis;
(e) ensuring that management has a process for identifying the principal business risks;
(f) overseeing the integrity of the internal control systems;
(g) ensuring that Nalcor has processes for operating within applicable laws and regulations;
(h) ensuring the company has a compensation philosophy and framework;
(i) ensuring a process is in place to measure the performance of senior executives of Nalcor;
(j) ensuring management creates a culture of integrity throughout the organization; and
(k) ensuring that succession plans are in place for senior management, including the President and CEO.

The Board met eight times in 2011, in addition to Committee meetings. Director attendance at Board and Committee meetings in 2011:

Directors	Board of Directors	Audit	Corporate Governance	Compensation	Safety, Health and Environment
Number of Meetings Held	8	2	1	2	3
Ed Martin	7				
Cathy Bennett	8		1		3
Tom Clift	8		1	2	2
Ken Marshall	8	2		2	
Gerry Shortall	8	2	1		

Nalcor has the following subsidiary companies, each with its own Board of Directors.

- Newfoundland and Labrador Hydro
- Churchill Falls (Labrador) Corporation Limited
- Nalcor Energy – Oil & Gas Inc.
- Nalcor Energy – Bull Arm Fabrication Inc.
- Twin Falls Power Corporation
- Gull Island Power Corporation
- Lower Churchill Development Corporation

CORPORATE GOVERNANCE

AUDIT COMMITTEE

The Audit Committee is comprised of two independent directors. All members of the Committee are required to have a basic understanding of finance and accounting and be able to read and understand financial statements, and at least one member of the Committee shall have accounting or related financial management expertise at a level of sophistication similar to that of Nalcor. The Committee is comprised of Gerald Shortall (Chair) and Ken Marshall.

The Audit Committee's primary duties and responsibilities are to:

(a) monitor the integrity of Nalcor's financial statements, financial reporting process and systems of internal controls;
(b) identify and monitor the management of the principal risks that could impact the financial reporting of the company;
(c) appoint, approve compensation, and monitor the independence and performance of the external auditors;
(d) provide oversight over the internal audit function;
(e) monitor the compliance with legal and regulatory requirements; and
(f) facilitate communication among the external auditors, Nalcor's Internal Audit Department, management and the Board.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the independent auditors. Subject to Board approval, the Audit Committee may retain, at Nalcor's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

The Committee regularly meets separately with the external auditor and Nalcor's Internal Audit Department and management. The Committee also regularly meets in-camera with only the Committee members present.

CORPORATE GOVERNANCE COMMITTEE

The Corporate Governance Committee consists of three directors as determined by the Board, all of whom are independent. The Committee is comprised of: Tom Clift (Chair), Cathy Bennett and Gerald Shortall. The Corporate Governance Committee is responsible for the following:

(a) developing governance principles for Nalcor and its subsidiaries that are consistent with high standards of corporate governance;
(b) identifying and recommending candidates for appointment to the Board for approval by the Shareholder; and
(c) reviewing and recommending a process for director orientation and assessment.

COMPENSATION COMMITTEE

The Compensation Committee is comprised of two members, both of whom are independent directors. The Committee provides oversight of all compensation and human resources issues for Nalcor and its subsidiaries. The Committee is comprised of: Ken Marshall (Chair), and Tom Clift. The primary responsibilities of the Committee include:

(a) undertake an annual performance review of the President and CEO;
(b) review and assess Nalcor's succession planning policies and practices;
(c) establish and maintain a compensation philosophy and framework;
(d) review and assess compensation and benefit policies and programs and pension plans;
(e) review collective bargaining mandates and any proposed tentative settlement; and
(f) review performance management practices and procedures.

Subject to the approval of the Board of Directors, the Committee may engage outside legal and technical specialists to assist the Committee in the discharge of their duties and responsibilities.

SAFETY, HEALTH AND ENVIRONMENT COMMITTEE

The Safety, Health and Environment Committee consists of two directors as determined by the Board, both of whom are independent. The Committee is comprised of: Cathy Bennett (Chair), and Tom Clift. The Safety, Health and Environment Committee's primary responsibilities include:

(a) reviewing and reporting to the Board of Directors on the company's maintenance of safety, environment and health policies, procedures and practices;
(b) reviewing with management whether the company's safety, environment and health policies are being effectively implemented and are in compliance with statutory and regulatory requirements;
(c) reviewing the findings of reports arising from internal and external audits and assessments of safety, environment and health issues, together with management's response;
(d) reviewing with management the impact of proposed legislation in matters of safety, environment and health on the operations of the company; and
(e) reviewing with management and making recommendations to the Board of Directors as appropriate on the company's safety, environment and health policies and procedures and any other matters relating to the safety, environment and health that it considers relevant.

CORPORATE GOVERNANCE

INDEPENDENCE

Nalcor Energy has a Director Independence Policy consisting of:

(a) a majority of the Board of Directors, including the Board chair shall be independent;
(b) all the members of the Board's Committees shall be independent;
(c) directors are required to provide a formal declaration indicating that they satisfy the Independence criteria;
(d) directors have a responsibility to discuss any potential conflicts that might impact their independence with the Board chair or the chair of the Corporate Governance Committee; and
(e) if directors do not satisfy the independence criteria, they should not participate in any discussion or voting relating to matters that contribute to the independence issue.

POLICY ON INDEPENDENCE OF EXTERNAL AUDITORS

Nalcor Energy has an Auditor Independence policy that governs all aspects of Nalcor's relationship with the external auditor, including:

(a) establishing a process for determining whether various audit and other services provided by the external auditor affects their independence;
(b) identifying the services that the external auditor may and may not provide to Nalcor;
(c) pre-approving all services to be provided by the external auditor to the company; and
(d) establishing a process for hiring current or former personnel of the external auditor in a financial oversight role to ensure auditor independence is maintained.

EXTERNAL AUDITOR'S FEES

The external auditor of Nalcor and its subsidiaries is Deloitte & Touche LLP. Deloitte has been the external auditor since 2003. Professional fees incurred in 2011 in connection with audit and audit-related service were $364,000 (2010 - $320,000) and fees related to non-audit services were $37,000 (2010 - $53,000).

Nain
Natuashish
Hopedale
Makkovik
Postville
Menihek
Rigolet
Twin Falls
Churchill Falls
Happy Valley-
Goose Bay
Mud Lake
Cartwright
Black Tickle
Paradise River
Muskrat Falls
PROPOSED
Gull Island
PROPOSED
Charlottetown
Port Hope Simpson
Mary's Harbour
L'Anse-au-Loup
Hawkes Bay
Cat Arm
Rattle Brook (PPA)
Snooks Arm
Hinds Lake
Grand Falls*
Buchans*
Stephenville
Star Lake*
Upper Salmon
Granite Canal
François
Grey River
Ramea

ENERGY PORTFOLIO

LEGEND

- Hydroelectric Generation Station
- Thermal Plant/Combustion Turbine
- Diesel Plant
- Wind Generation
- Offshore Oil Projects
- Industrial Fabrication Site
- Diesel Plant operated on behalf of Mushuau Innu First Nation

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PPA POWER PURCHASE AGREEMENT

nalcorenergy.com


NEWFOUNDLAND AND LABRADOR HYDRO
CHURCHILL FALLS
OIL AND GAS
LOWER CHURCHILL PROJECT
BULL ARM FABRICATION