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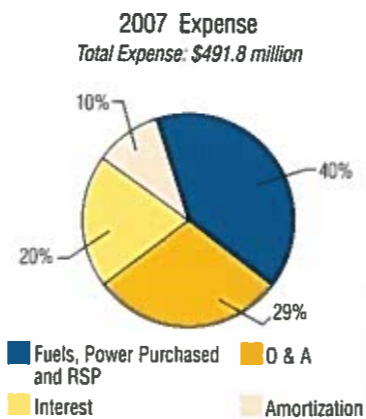
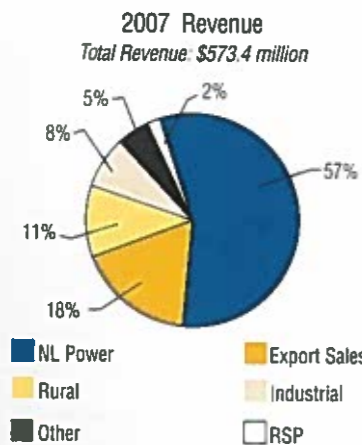
# Key Financial and Operating Highlights

## Financial Highlights

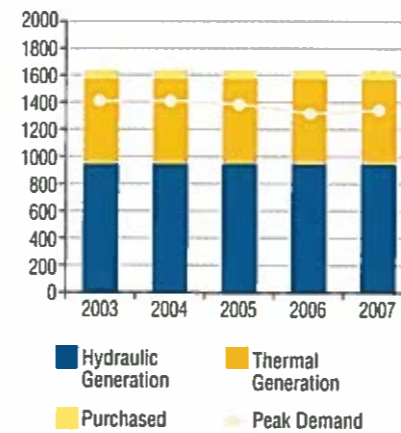
Years ended December 31 (millions of dollars)	2007	2006	2005
Revenues	573.4	548.0	532.5
Net income	81.6	70.0	71.9
Capital assets, net	1,825.7	1,791.5	1,781.6
Long-term debt	1,187.8	1,394.7	1,174.8
Shareholder's equity	677.8	574.4	507.0
Dividends	-	2.6	55.8
Debt to capital	65.0%	70.0%	74.0%
Return on capital employed	9.2%	8.9%	8.8%

## Operating Highlights

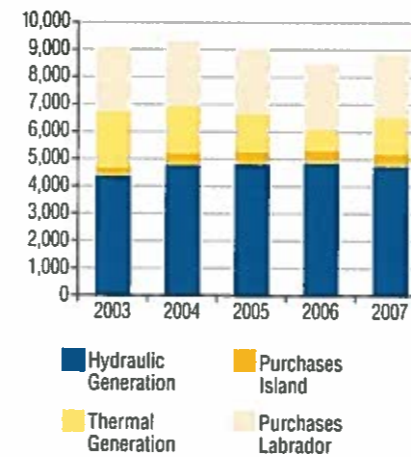
Years ended December 31	2007	2006	2005
Number of customers	35,619	35,381	35,343
Installed generating capacity (MW)			
Hydroelectric	6,611	6,592	6,592
Thermal	640	640	640
Diesel	56	56	56
Energy sales (GWh)			
Newfoundland and Labrador	8,695	8,397	9,011
Export	30,055	31,318	30,170
Transmission lines (km)	4,781	4,781	4,781
Peak demand (MW)	6,898	6,897	6,969



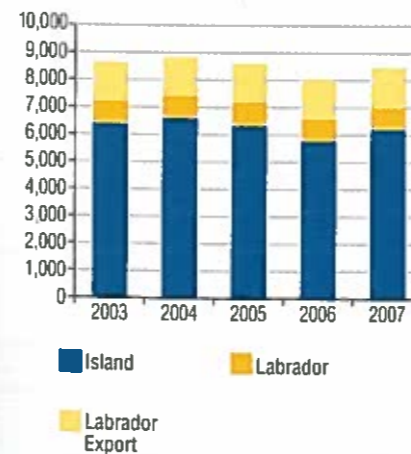
Island Interconnected System  
Gross Generating Capacity  
and Peak Demand  
Megawatts (MW)



Interconnected Systems  
Gross Energy Generated  
and Purchased  
Gigawatt Hours (GWh)



Interconnected System  
Energy Sales  
Gigawatt Hours (GWh)



## Table of Contents

- Message from the Chair .....1
- Message from the CEO .....2
- Corporate Overview .....4
- 2007 Performance Review .....6
- Management's Discussion and Analysis .....22
- Management Report.....42
- Auditors' Report .....43
- Financial Statements.....44
- Financial Statistics .....66
- Operating Statistics .....67
- Executive Leadership Team .....68
- Officers .....69
- Board of Directors .....70
- Corporate Governance .....72

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## Message From the Chair

This past year was full of opportunity and excitement for Newfoundland and Labrador Hydro (Hydro). In September, our Shareholder, the Government of Newfoundland and Labrador, released the Newfoundland and Labrador Energy Plan - Focusing Our Energy. This was followed with the proclamation of the Energy Corporation Act in October, establishing a new provincial energy corporation which will assume 100 per cent ownership of Hydro and its subsidiary companies. The energy corporation will take a lead role in the province's participation in the development of our energy resources.

During 2007, the Board of Directors provided strategic direction and oversight to management as the company was restructured to pursue new business opportunities in the energy sector. The Board also completed a comprehensive governance review for Hydro and implemented a number of corporate governance changes during the year. The goal of this review process was to achieve best-practice governance policies and processes to successfully grow our business.

Our 2007 Business and Financial Report highlights our progress and performance on the company's long-term strategy. The Board is particularly proud of Hydro's commitment to improving safety performance in 2007 and commends the work of management, union and staff for their commitment to safety excellence.

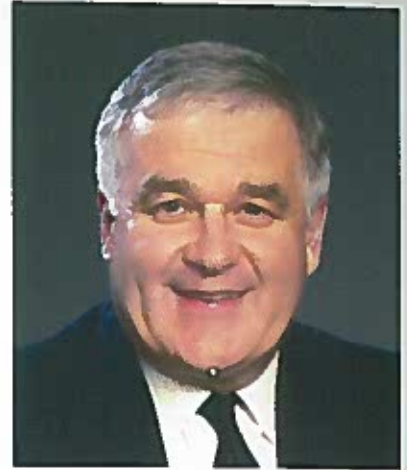
This past year also saw a change in Board members. On December 18, 2007, Mr. Dean MacDonald ended his chairmanship of the Board of Directors. Mr. MacDonald served as chair through a new mandate and the development of a new corporate strategy for Hydro. He has a strong vision for Newfoundland and Labrador and provided sound leadership and guidance throughout his tenure. On behalf of the Board, I thank Mr. MacDonald for his contribution to Hydro and to our province.

I also thank our past Board members - Mr. Bill Kelly, Ms. Linda Sheppard and Mr. Craig Tucker - for their hard work and commitment to the development of Hydro during their years of service, and welcome Ms. Cathy Bennett to the Board.

I look forward to working with the Board members to develop the opportunities that lie ahead in 2008 and beyond.



John Ottenheimer  
Chair, Board of Directors



## Message From the CEO

This past year was filled with opportunity and the enthusiasm and interest that comes from positive change. In September, our Shareholder, the Government of Newfoundland and Labrador, released its long-term energy policy direction through the Energy Plan - Focusing Our Energy. This progressive document lays out a strong vision for the province, focused on the maximization of its energy resources.

One of the key actions taken to enable the effective implementation of this policy direction was the creation of a new provincial energy corporation. It is the new parent company of Hydro, Churchill Falls (Labrador) Corporation and other related subsidiaries, and will take a lead role in developing the province's energy resources.

As a result of the formation of the energy corporation, the company underwent the restructuring necessary to facilitate our pursuit of business opportunities in the broader energy sector. This has allowed us to prudently ramp up our expertise in key areas required to facilitate our growth strategy and appropriately reinforce the separation of regulated operations from other aspects of the business.

Throughout the company, our people are focused on business excellence to facilitate the growth of a diversified and viable energy business and drive results in our core businesses. Performance is focused around eight corporate goals: Safety, Environment, Finance and Governance, Growth, Operational Excellence, Lower Churchill, People and Community. This report highlights our key accomplishments in these areas.

### SAFETY COMES FIRST

For a business like ours, safety is our key priority and we appreciate that sustainable, world-class safety performance does not come easily. We are pleased with our 2007 safety performance but understand it's a small step on a long and relentless journey to safety excellence. We are looking for consistent safety performance year-over-year and recognize this takes time, significant effort and a strong culture. We are presently focused on making a fundamental shift in our safety culture.

The first step in our safety quest was to ensure we could assess our performance appropriately. We successfully implemented a comprehensive safe workplace observation program which focuses on reporting and fixing safety-related observations to make the workplace safer and prevent major incidents. The rollout of the program led to dramatically increased reporting and facilitated essential safety dialogue at every level of the company.

It would have been impossible to make the strides we have without the commitment, leadership and passion of our safety partner, the International Brotherhood of Electrical Workers (IBEW). We have achieved a mutual respect and understanding of the effort required to enact change in our safety culture and performance. It is clear we have both committed to the long journey ahead and we agree on the fundamental outcome - zero injuries. This means every worker is safe, every day.

### BUILDING FOR LONG-TERM SUCCESS

One of our key areas for growth is the oil and gas sector. In 2007, on behalf of our Shareholder, we signed Memorandums of Understanding for equity stakes in the White Rose Growth Project and the Hebron-Ben Nevis and West Ben Nevis (Hebron) oil fields. Once in production, these projects will be significant contributors to the company's portfolio. We are also pursuing other offshore developments and West Coast onshore developments.

The company also continues to advance the Lower Churchill Project. Our present focus is to provide our Shareholder with the data and information necessary to consider a sanction decision. This project is one of the best undeveloped hydroelectric resources in North America. In an era of continuously rising oil prices and electricity costs, there is tremendous value in a long-term, stable and renewable energy supply for the province, industry and other North American markets.



Other key areas of progress have been in wind energy and research and development (R&D). We awarded two 27 megawatt (MW) wind power contracts in the communities of St. Lawrence and Fermeuse. These projects will be instrumental in the reduction of thermal generation emissions, providing green power for 14,000 homes on the island. In addition, the five-year Ramea Wind-Hydrogen-Diesel Project started in 2007. This R&D project is building a viable commercial solution for deployment to other isolated diesel communities in the province, and potentially around the world.

Our growth is predicated by a strong focus on our core businesses; without strong performance in our base business, we will not be successful in our expansion. In particular, 2007 was another stellar year for our Churchill Falls Operations - achieving 99.7 per cent of maximum revenue from the critical Guaranteed Winter Availability Contract, driven by operating uptime. Our Regulated Operations Division faced challenges with key operating measures due to unplanned outages at our Holyrood plant and several weather related outages which impacted key performance indicators; however, customers' satisfaction in our rural operations remains high.

### PEOPLE ARE SHAPING OUR FUTURE

We are in a time when the labour market has fundamentally shifted and workers are in demand across the country. We have been fortunate to continue to recruit and retain some of the best and brightest people in the marketplace. As we embark on an ambitious growth plan, it will be vitally important to remain competitive and offer employees a work place and work experience where they can make a difference. We believe this is our competitive advantage and we are focused on becoming one of the country's top employers.

We are also continuing to strengthen our relationship with the IBEW. Our union partners remain valued contributors on key corporate initiatives; particularly, safety, corporate planning and the establishment of our core values.

In 2007, a cross-sectional Values Engagement Team embarked on a journey to review and revitalize our statement of corporate values for the company. Their goal was to identify the beliefs and principles our employees feel should guide our actions and decisions. Their work resulted in the identification of seven "core" values, which are proudly stated in the front of this report.

### MINIMIZING ENVIRONMENTAL IMPACTS

The Energy Plan outlines specific measures to address environmental concerns related to the Holyrood Generating Station. The long-term plan is to replace the energy provided by the plant with electricity from the lower Churchill development through a transmission link to the island. In the event the Lower Churchill Project does not proceed, scrubbers and precipitators will be installed at the plant.

We are fortunate to have vast hydro resources. The lower Churchill resource, combined with the upper Churchill and our existing hydro generating facilities on the island, provide the opportunity for approximately 98 per cent of the province's electricity requirements to be met with stable, renewable power. It is a unique and enviable position when compared with many other jurisdictions, and will provide our customers with stability over the longer term in relation to other areas where thermal generation is the predominant power supply.

### INVESTING FOR THE FUTURE

The bulk of Hydro's regulated assets have now been in service for almost 40 years, and in some cases, longer. To ensure the continued safety and reliability which our customers have come to expect, Hydro is completing a long-term capital investment plan, as well as a comprehensive asset maintenance strategy. This work will lay out the required upgrades and investments to continue the level of service and reliability of the provincial electrical system.

### LOOKING FORWARD

When I look ahead I see both opportunities and challenges. Our performance has improved in many key areas over the past two years; however, there is still much room for progress. I am proud of the successes achieved in 2007 and grateful to our employees for the positive contribution they have made to our operations. I look forward to 2008 as we seek to improve our performance and position the company as a leader in the energy sector.

Ed Martin  
President and CEO



## Corporate Overview

Hydro is a Crown corporation, owned by the Province of Newfoundland and Labrador, and is the parent company of Churchill Falls (Labrador) Corporation (CF(L)Co), Lower Churchill Development Corporation Limited, Gull Island Power Company Limited and Twin Falls Power Corporation Limited.

In October 2007, the Government of Newfoundland and Labrador proclaimed legislation to create a new provincial energy corporation charged with pursuing business opportunities in the energy sector. The new Crown corporation, which commenced operations in 2008, will be wholly owned by the province and will be the parent company of Hydro, CF(L)Co, other subsidiaries currently owned by Hydro, and new entities created to manage the province's investments in the energy sector.

Headquartered in St. John's, Hydro supplies over 80 per cent of the province's electrical energy, has operations in wind generation and research and development, and is expanding into oil and gas.

The combined installed generating capacity of the company and its subsidiaries is 7,307 MW, of which 90 per cent is clean, renewable hydroelectric power. The company is the fourth largest power utility in Canada and the province's main energy provider with electrical sales of 38,750 gigawatt hours (GWh) in 2007 - 8,695 GWh for domestic use and 30,055 GWh for export.

There are over 1,200 employees in four lines of business: Regulated Operations, Churchill Falls Operations, the Lower Churchill Project and Business Development.

### REGULATED OPERATIONS

Committed to operational excellence, the company's regulated business is dedicated to delivering safe, reliable, least-cost power to industrial, utility and over 35,000 direct customers in rural Newfoundland and Labrador.

Regulated assets include: nine hydroelectric generating stations, one oil-fired plant, four gas turbines, four interconnected diesel generating stations, and 21 isolated diesel generating and distribution systems. Hydro also maintains 54 high-voltage terminal stations, 25 lower-voltage interconnected distribution substations, and thousands of kilometres of transmission and distribution lines.

### CHURCHILL FALLS OPERATIONS

The Churchill Falls Generating Station, one of the largest underground powerhouses in the world, has 11 turbines with a rated capacity of 5,428 MW. In 2007, more than 33 terawatt hours of electricity was produced, with the majority of that energy sold to Hydro-Québec through a long-term power purchase contract set to expire in 2041. Most of the remaining production is used for mining operations in Labrador West and Hydro's Labrador Interconnected System, with any excess power sold to Hydro-Québec under a short-term recall agreement.

The company ensures that the men and women who operate the Churchill Falls Generating Station, as well as their families, live in a comfortable community with the expected amenities of any town. The community of Churchill Falls has a population of 650 people. The company operates the town, including a school, hotel, grocery store, theatre, library and recreational facilities.

The focus of CF(L)Co is to deliver high quality, reliable power to customers and ensure future generations benefit from this provincial resource through long-term asset management.

### LOWER CHURCHILL PROJECT

The lower Churchill River hydroelectric resource is one of the key elements in the province's energy warehouse.

The potential of the lower Churchill resource, one of the best undeveloped hydro resources in North America, is immense. Together, Gull Island (2,000 MW) and Muskrat Falls (824 MW) have the capacity to power all of the homes in Atlantic Canada and parts of Ontario. Combined with the existing Churchill Falls Generating Station, the three developments could produce the electrical equivalent of 225,000 barrels of oil a day - forever. This much needed resource of clean, stable, renewable energy provides the opportunity for Newfoundland and Labrador to meet its own domestic and industrial needs in an environmentally sustainable way, with enough power remaining to export to other jurisdictions where the demand for clean energy continues to grow.

### BUSINESS DEVELOPMENT

With an abundance of non-renewable and renewable resources, Newfoundland and Labrador is positioned to be a strategic, long-term supplier of energy to further meet the growing demands in eastern North America. This division is also expanding its operations to be a supplier of oil and gas based energy.

Hydro's near-term strategy for growth in the oil and gas sector is to obtain equity positions in various stages of the value chain, and in 2007, Hydro successfully entered the oil and gas area of the energy sector. This included negotiating an equity position in the White Rose Growth Project, and entering into a Memorandum of Understanding (MOU) on an equity position in the Hebron oil fields.

For renewable resources, this division has operations in wind generation and research and development. Hydro's wind development strategy involves pursuing three distinct opportunities. On the island, two contracts have been awarded for the development of 54 MW of wind power; in Labrador, monitoring is ongoing to determine the wind resource potential in conjunction with the Lower Churchill Project; and in Ramea, a remote community on the South Coast of Newfoundland, a research and development project is focusing on an isolated wind-hydrogen-diesel generation solution.





# safety

To be a  
world-class  
safety  
leader.



## Think Safety First

Hydro is committed to continuous improvement and sustained safety performance and is striving for zero workplace injuries. To achieve this, the company has established a framework built on: leadership, procedures and equipment, competence, supportive culture, union management alignment, responsibility and reporting to strengthen safety culture so world-class performance is achievable and sustainable.



### See it. Fix it. Report it.

It's been proven that one of the best ways to make the workplace safer and prevent serious incidents in an organization is to report, collect and analyze data on unsafe conditions, near misses, loss incidents and safe work practices. In January 2007, Hydro implemented its Safe Workplace Observation Program (SWOP) to do just that. SWOP significantly enhances our capability to analyze and correct health and safety deficiencies in the workplace. Together, employees, contractors and the public reported almost 4,500 SWOP observations in 2007. The concept of SWOP is simple – See it. Fix it. Report it.

This past year, the company met or exceeded its safety targets – achieving a 60% reduction in disabling injuries and a reduction of almost 30% for medical aid injuries. As well, overall injury incidents decreased by 45%. While this is an improvement over 2006, there is still more to do to achieve a best-in-class safety performance.

In January, Hydro implemented a new process for collecting and reporting incidents, near misses and safe work practices – Safe Workplace Observation Program (SWOP). Almost 4,500 SWOP observations were reported by the end of the year. This safety program

significantly enhances Hydro's capability to analyze and correct health and safety issues in the workplace and is critical to preventing major or serious incidents.

Safety programs and initiatives cannot be effective unless accompanied by a strong safety culture. Improving the safety culture within Hydro is a key component of achieving the company's safety goal and sustained safety performance. A comprehensive safety culture survey of employees' attitudes and opinions was completed in May. In addition, working with the Corporate Safety Advisory Committee (CSAC), a series of employee focus groups were held with Occupational Health and Safety Committees to identify the key areas and issues that need to be addressed to help strengthen the company's safety culture. The survey results were fundamental in the development of an action plan for safety culture improvement. Both of these research initiatives provided important data and insights into the current culture and identified steps that need to be taken on the road to improvement.

CSAC also completed a review of Hydro's corporate safety rules. With a goal to promote and foster personal responsibility for safety as a core employee value, a new Safety Credo was developed and will be rolled out in 2008.

In May, CEO and President Ed Martin signed the inaugural CEO Leadership Charter for Newfoundland and Labrador. Hydro was one of 30 businesses chosen by the Workplace Health, Safety and Compensation Commission to lead this initiative. By signing the Charter, Hydro has committed to achieving breakthroughs in occupational health and safety performance.

Hydro's safety objective is to reduce the number of workplace injuries to zero and achieve sustained performance. The company has charted a course to accomplish this aggressive and achievable objective. Many safety improvements have been realized since 2005, but the journey is long and Hydro's efforts will continue to be relentless.

### Key Highlights:

- Surpassed SWOP observation target by 163%.
- Held the first in-house safety summit with Occupational Health and Safety Committee representatives.
- Reduced disabling injuries by 60% and medical aid injuries by almost 30%.





# environment

To be an  
environmental  
leader.



## Focusing on Continuous Improvement

Hydro has chosen the ISO 14001 Environmental Management System (EMS) standard, developed by the International Organization for Standardization, to drive the continual improvement of the company's environmental performance.



### Saving Energy with LEDs

Hydro partnered with the Department of Natural Resources and Newfoundland Power to help consumers make the switch to energy-efficient LED lights this past holiday season. This initiative will result in annual electricity savings of up to 410,000 kilowatt hours, save over 650 barrels of oil, and reduce greenhouse gas emissions by up to approximately 315 tonnes. LED lights

are energy efficient, using up to 90% less energy than traditional holiday lights and lasting up to 10 times longer. Plus, they are safe and durable.

Through the EMS, Hydro seeks to mitigate its impact on the environment. The EMS covers a broad range of areas: alternative energy and conservation, emissions control, waste management and recycling, spills management, environmental site assessment and remediation, and species and habitat diversity. Hydro reports regularly on its environmental performance through its annual Environmental Performance Report, which is posted on the corporate website.

Hydro has a mandate to meet the province's growing electricity needs. Most of this electricity comes from clean hydroelectric power; however, between 15 to 25% of the island's electricity each year comes from fossil-fuel fired generation from the Holyrood Generating Station. The amount of thermal generation varies based on demand, as well as the amount of water available in reservoirs for hydroelectric generation. The company has a clear focus on minimizing thermal generation as much as possible.

The company is also committed to reducing emissions from the Holyrood plant and has taken numerous steps to achieve this target, including: switching to a cleaner fuel which continues to reduce some emissions by 50%; sanctioning 54 MW of wind power on the island which will reduce emissions from the Holyrood plant by almost 15% and provide green energy for 14,000 homes; practicing and promoting energy conservation; and continuing to achieve operational efficiencies.

The province's Energy Plan outlined future alternatives for the operation of the Holyrood Generating Station. The focus is on reducing or eliminating emissions from the plant. The long-term plan is to develop the Lower Churchill Project and construct a transmission link from Labrador to the Island of Newfoundland. In the event the Lower Churchill Project does not proceed as anticipated, scrubbers and precipitators will be installed at the plant to reduce emissions.

Hydro is also helping consumers use energy wisely. HYDROWISE, Hydro's energy conservation and efficiency program, provides consumers with the knowledge to make informed decisions about managing their electricity use. In 2007, Hydro implemented several energy conservation initiatives, including:

- Offering double rebates from July to November through the Wrap Up for Savings Program for insulation upgrades in electrically-heated homes.
- Partnering with government and Newfoundland Power on two energy conservation initiatives. The SAVE Energy Event, which distributed over 22,000 CFL bulbs in Burin and Labrador West; and Holiday Lightswitch, which exchanged 10,000 sets of traditional outdoor holiday lights for LED holiday lights in 17 municipalities.

While the company has made progress in reducing its impact on the environment, Hydro will continue to develop long-term plans to achieve its environmental targets and goal of becoming an environmental leader.

### Key Highlights:

- Energy Conservation and Demand Management Potential Study was completed in partnership with Newfoundland Power to examine what opportunities exist to help electricity consumers conserve energy.
- In partnership with government and Newfoundland Power, launched two energy conservation initiatives which have the potential to save up to one million kilowatt hours annually.





# finance & governance

To strengthen our financial and governance structure.



## Preparing for Growth

The Government of Newfoundland and Labrador proclaimed legislation in 2007 creating the province's new energy corporation, putting in motion a significant restructuring of Hydro and its subsidiary companies.



### Corporate Governance

Corporate governance is the system by which businesses are directed and controlled. It specifies the distribution of rights and responsibilities between the board, managers, shareholders, and other stakeholders, and spells out the policies and procedures for making decisions on corporate affairs. Beginning in 2006, Hydro's Board of Directors undertook a comprehensive governance review to identify and recommend implementation of governance best-practices. Revised Board Committee mandates, an auditor independence policy, a whistleblower policy, and a code of business conduct and ethics have all been approved.

During the second half of the year, the company commenced efforts to transfer certain assets, employees and contracts to the energy corporation. Throughout 2008, restructuring efforts will continue as the energy corporation takes the lead role in the province's participation in the development of provincial energy resources. The company will also focus on assessing mechanisms and structures required to facilitate more investments. All activities of the energy corporation will be consistent with, and guided by, the province's approach to energy development and the provincial Energy Plan.

The restructuring of the company is necessary to clearly separate regulated activities from non-regulated activities and to establish a platform to facilitate and finance future growth opportunities. This separation is critical to ensure that costs, expenditures and liabilities related to new investments do not negatively impact regulated activities. It will also enable potential lenders, investors and credit rating agencies to better understand the various business drivers, financial strengths and risks of the various business entities.

A successful company must have the financial strength and flexibility to create value and grow its operations. In 2007, Hydro commenced the development of a long-term financing strategy for the company that will facilitate future business investments. Hydro continued to strengthen its financial position and capital structure by retaining earnings in the company rather than making dividend payments to the Shareholder. This improvement in capital structure is essential for future growth.

An area of continued focus in 2007 was corporate governance. Hydro completed the implementation of changes resulting from a corporate governance review process, which began in the previous year. The objective of this review was to identify and implement best-practice corporate governance policies and procedures. A strong corporate governance system is essential as the company embarks on major investments and enters new segments of the energy industry.

### Key Highlights:

- Completed corporate restructuring to align with the province's energy corporation legislation.
- Commenced the development of a financing strategy for future business initiatives.
- Finalized a corporate governance review and implemented recommendations.





# growth

To grow a diversified and viable energy business.

## Capitalizing on Business Opportunities

This year marked a significant milestone for Hydro as the company officially entered the oil and gas area of the energy sector.

In 2007, the company signed a formal agreement with the partners of the White Rose Growth Project to acquire a five per cent equity interest in the planned oil field expansion. First oil production from the expansion fields is expected in 2009. Hydro also entered into a non-binding MOU with the partners of Hebron to acquire a 4.9 per cent equity interest in the Hebron oil fields. Development of these projects will provide significant benefits and opportunities for the people of Newfoundland and Labrador.



### Wind Development Breaks Ground

In July, Hydro took part in the official groundbreaking ceremony of the province's first commercial wind farm – a 27 MW wind project in St. Lawrence on the Burin Peninsula. In January, Hydro signed a 20-year power purchase agreement with NeWind Group Inc. that will see the installation of nine, three-megawatt wind turbines. The wind farm is expected to be in production by the end of 2008 and generate approximately 100,000 megawatt-hours per year – enough energy to power 6,800 homes and offset up to 165,000 barrels of fuel burned annually at the Holyrood Generating Station.

Wind is a valuable energy resource and Hydro has developed a strategy to leverage this source of clean, renewable energy. In 2007, Hydro secured power purchase agreements for 54 MW of wind energy on the island. On average, when compared to the cost of burning oil at the Holyrood Generating Station, these contracts will save consumers approximately seven million dollars annually over the 20-year life of the contracts. Both wind projects are expected to start production in late 2008.

In addition, Hydro secured three million dollars from the Atlantic Innovation Fund towards a five-year, \$10 million innovative research and development project for an isolated wind-hydrogen-diesel generation solution. The project is located in the community of Ramea, a small remote island on the South Coast of Newfoundland. This unique energy project has the potential to significantly reduce Hydro's reliance on diesel generation and provide clean, renewable energy to isolated customers. This project is one of the first in the world to integrate generation from wind, hydrogen and diesel in a remote, isolated electricity system.

Hydro also completed negotiations with the Iron Ore Company of Canada and signed agreements for the purchase of the Menihék Power Station and associated Labrador assets. Along with this sale, the company signed a 40-year power purchase agreement with Hydro-Québec to provide power to three northern Québec communities. With this agreement, Hydro retains control over a provincial asset and resource while adequately managing financial and operating risks.

The company will continue to assess growth opportunities for renewable and non-renewable resources with an approach to maximizing benefits from these resources to help build a stronger economy in Newfoundland and Labrador.

### Key Highlights:

- Signed MOUs to acquire a five per cent equity stake in the White Rose Growth Project and a 4.9 per cent equity stake in Hebron.
- Completed power purchase agreements for 54 MW of wind power on the island – 27 MW in St. Lawrence and 27 MW in Fermeuse.





# operational excellence

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

## Commitment to Customers

Hydro's commitment to safety underlies every business decision and is the foundation of the company's dedication to operational excellence.

Over the past seven years, the Churchill Falls Generating Station has consistently reached its winter availability targets. In 1999, CF(L)Co entered into a Guaranteed Winter Availability Contract (GWAC) with Hydro-Québec. To maximize revenue from this contract, the Churchill Falls Generating Station is focused on delivering 99% availability for five months of the year – November to March. In 2007, Churchill Falls Operations achieved a five-month average of 99.7% of maximum additional revenue. Hydro's island generating facilities performed better in 2007 than 2006, achieving an average availability of 94% compared to 93%. However, winter availability targets on the island were missed due to extensive repairs required on one of the turbines and one of the three boilers at the Holyrood Generating Station.



### Bay d'Espoir Powers the Province for over 40 Years

August 15, 2007 marked the 40th anniversary of the commissioning of the Bay d'Espoir Hydroelectric Generating Facility. Forty years later, Bay d'Espoir is still a critical part of our energy infrastructure, producing long-term, clean, stable power to island customers.

Over 700 MW of power is produced from the Bay d'Espoir system. There are a string of reservoirs running 150 km, starting at Victoria Lake, near the road to Burgeo, to Bay d'Espoir. Through a man-made array of dams and canals, this water is directed to generating plants at Granite Canal, Upper Salmon and to its final tidewater destination at Bay d'Espoir.

The performance of the Holyrood Generating Station was a major focus in 2007. Built almost 40 years ago, the operation of this critical asset was significantly impacted due to age and deterioration of components. In 2008, Hydro will move forward with a proposal for a long-term condition assessment of the Holyrood plant. This assessment will help determine the potential life expectancy of the plant and identify future capital requirements necessary to provide the service customers expect.

A significant portion of Hydro's electricity system assets and infrastructure is 30 to 40 years old and requires repair or replacement. In 2007, Hydro made capital investments of \$59 million, much of which was targeted at replacing or refurbishing deteriorated, defective or obsolete electricity system components. This is essential to ensure Newfoundlanders and Labradorians continue to receive safe, reliable and cost-effective power. Hydro anticipates continued and increased investment will be required into the future, and is completing a long-term investment plan, as well as a comprehensive asset management strategy.

In 2007, Newfoundland and Labrador faced a number of severe wind and ice storms that brought challenges for Hydro and its customers. These major storms resulted in a larger than expected number of weather-related outages and caused extensive damage to transmission and distribution systems. Hydro will continue to evaluate its assets to ensure they are capable of withstanding the harsh climate of the province.

Hydro also directly serves over 35,000 customers in 220 communities throughout the province. In 2007, 89% of residential customers viewed the company positively and said they were satisfied with the company's performance.

The future of Hydro's operations divisions will be focused on improving safety performance and maintaining environmental commitment while continuing to provide all electricity consumers with exceptional value.

### Key Highlights:

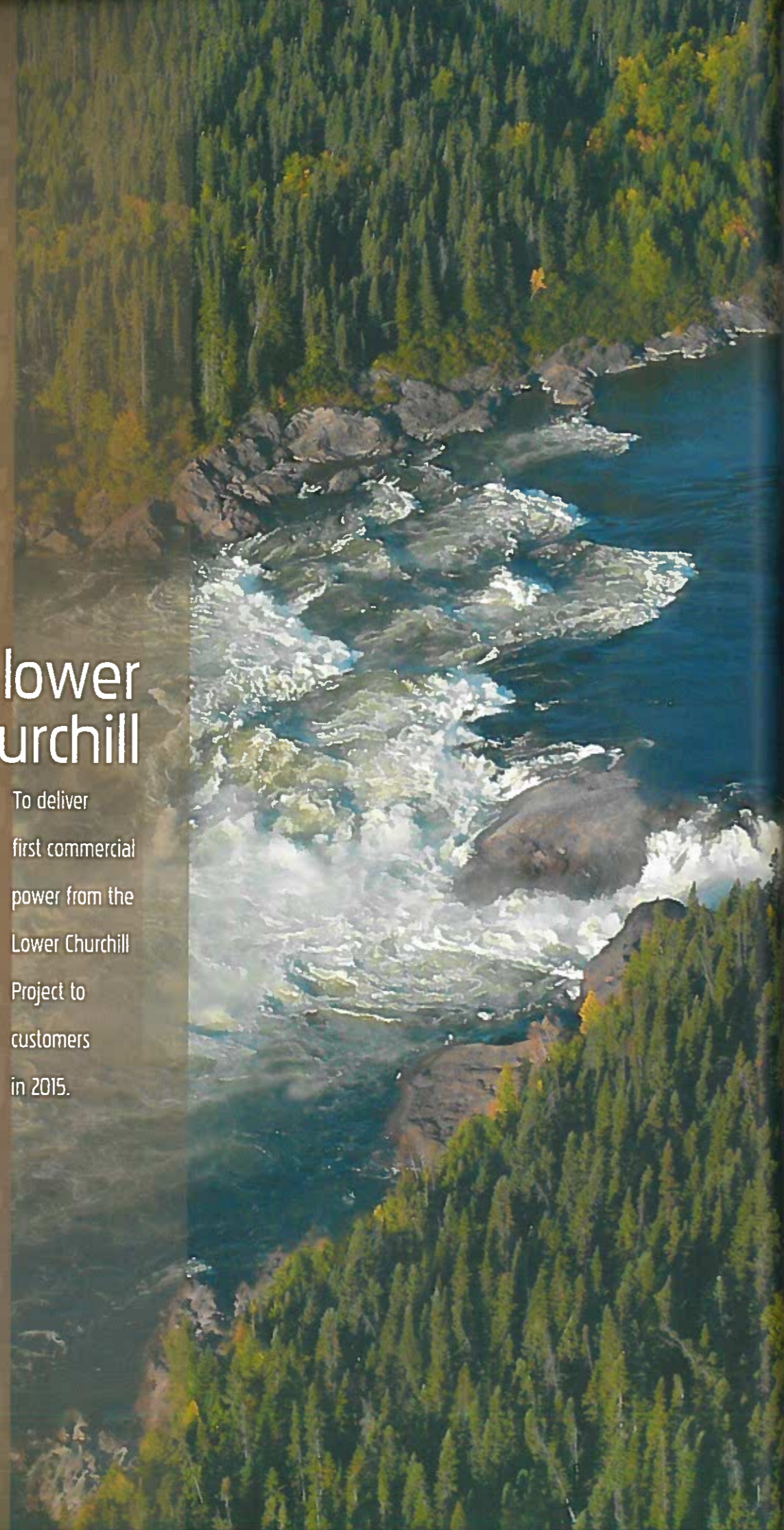
- Churchill Falls Operations delivered 100% availability for three of the five winter months.
- Celebrated the 40th anniversary of first power from the Bay d'Espoir Hydroelectric Generating Facility.





# lower churchill

To deliver first commercial power from the Lower Churchill Project to customers in 2015.



## Building for the Future

As concern for the environment grows, so too does the need for clean, renewable and cost-efficient energy sources. Located 225 kilometres from the Churchill Falls Generating Station, the proposed Lower Churchill Project will significantly increase the province's renewable electricity supply.

The Lower Churchill Project team is pursuing project development on multiple fronts. Like any development project of this magnitude, there are many components to be addressed: an environmental assessment process, analysis of market access options and market destinations, review of previous engineering design work and preparation for further studies and field work, negotiations for an Aboriginal Impacts and Benefits Agreement and development of a financing strategy. A significant amount of work happened in these areas throughout 2007.



### Assessing HVDC Sub-sea Cable Route

This past summer, Hydro worked with two engineering consulting firms, Fugro Jacques Geosurveys Inc. (FJGI) and Statnett, a public enterprise owned by the State of Norway, to assess the high-voltage direct current (HVDC) sub-sea cable route that could transmit lower Churchill power from Labrador to the Island of Newfoundland and on to the Maritime provinces.

The Anticosti vessel was used to conduct offshore geophysical surveys to map the seabed and sediment thickness along the bottom of the Atlantic Ocean, leading to points in Newfoundland, Nova Scotia and New Brunswick. The vessel also collected video of the seabed and sediment samples from proposed routes that had been defined through assessment of computer study work and regional multi-beam echo sounder mapping. Once the information was gathered, it was given to Statnett, who will provide a route configuration and cost estimate.

The provincial government determined that an Environmental Impact Statement (EIS) is required for the Project, and a full review panel assessment has been called under the federal environmental assessment process. In the spring of 2007, the Lower Churchill Project team hosted the first round of public open houses in Churchill Falls, Happy Valley-Goose Bay, North West River and Labrador City. These public information sessions, as well as individual stakeholder meetings, will continue as the team prepares to file the EIS in 2008.

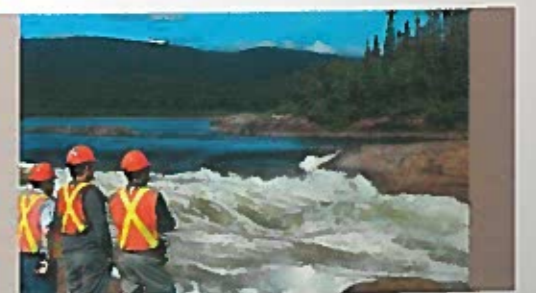
Work also progressed on assessing market access options. Once the domestic and industrial energy needs of Newfoundland and Labrador have been met, potential market opportunities for lower Churchill power exist in Ontario, Québec, the Maritime Provinces and the Northeastern United States. In February, Hydro filed an application for long-term transmission service from the New Brunswick System Operator as part of the continued assessment and analysis of the sub-sea option. As well, in June the government announced the signing of a MOU with Rhode Island which institutes a two-phase process to explore an arrangement for the sale and purchase of power. These studies will provide an understanding of the costs and technical considerations for market access.

As the environmental assessment proceeded and the market access continued to be investigated, extensive engineering work took place in 2007, including further field investigation work at both the Gull Island and Muskrat Falls project sites, as well as along the potential transmission routes. The 2007 field program consisted of surveying, test pitting, exploratory drilling and seismic investigations.

Sub-sea surveying of the Strait of Belle Isle and Cabot Strait was also completed in 2007. This work defined a route configuration and the cost estimate of the sub-sea route option to the island and across to the Maritime markets. This preliminary engineering work will assist in preparation for environmental and engineering activities leading to Project sanction.

### Key Highlights:

- Completed preliminary engineering field work at Gull Island and Muskrat Falls project sites.
- Completed offshore geophysical surveys of the Strait of Belle Isle and the Cabot Strait.





# people

To ensure a highly skilled and motivated team of employees who are strongly committed to Hydro's success and future direction.



## Focusing on Our People

One of Hydro's corporate goals is to be recognized as one of Canada's best employers. In an effort to achieve this, Hydro is focused on building a work environment that values the skills and commitment of its employees and recognizes them for their efforts. In 2007, key areas of concentration were: the completion of an organizational review of vision and values, a performance management review for non-union employees, union/management negotiations, succession planning, employee recognition and leadership development for front-line supervisors.



### Values Engagement - What Hydro Stands For and Believes In

In 2007, we committed to review our corporate values. The goal was to identify the beliefs and principles we feel must guide our actions and decisions at work. This was achieved with the help of

our Values Engagement Team (VET) who met with, and heard from, hundreds of fellow employees. Based on employee input, the VET proposed a values statement and seven "core" values. The statement and values capture the essence of Hydro and is fully aligned with our mandate as the province's energy corporation and our exciting vision for the future.

The company has completed a process to review its vision and corporate values. This review involved a corporate-wide engagement process with a cross-sectional employee team and extensive consultations. Through this process, every employee across the company was given the opportunity to provide input on the company's corporate values. These values will reflect the fundamental principles that guide the actions and decisions the company takes in pursuing its vision. Hydro's statement of corporate values will be rolled out in 2008.

Another key objective was to improve the company's performance management process. Hydro implemented 180° feedback for all non-union employees and 360° feedback for those with direct reports outside of the bargaining unit. This performance management process is important to motivate individual performance, provide employees with feedback on their work, and appropriately recognize and reward employees for their performance.

A considerable amount of work has been done with both IBEW locals and in early 2007, the company successfully renegotiated the collective agreements with both IBEW unions. This success was attributed to the cooperation and commitment of both union and management negotiating teams.

Hydro's ability to deliver on its goals depends on the strength of its people. In 2007, the company enhanced its succession planning processes to ensure it can sustain current and future business development. As the company grows, new opportunities will be created for employees to build their skills, knowledge and experience. At the same time, Hydro must work even harder to attract and retain the best people in a very competitive labour market.

A company-wide Employee Opinion Survey was conducted to assess progress in maintaining a highly motivated workforce, as well as identify areas that may require additional attention or measures. Both the participation rate and the overall average score increased. Employees' level of commitment, support for the company and overall satisfaction continue to be strong. Hydro will use this feedback as the company moves forward to become a best employer in Canada.

### Key Highlights:

- Finalized negotiations for IBEW 1315 and 2351.
- Achieved an 81% response rate in the Employee Opinion Survey.
- Completed extensive research for a company-wide Employee Recognition Program to be implemented in 2008.





# community

To be a valued corporate citizen in Newfoundland and Labrador.



## Supporting Our Communities

Giving back to communities in Newfoundland and Labrador is a priority for Hydro. The company makes every effort possible to be a valued corporate citizen and improve the quality of life for people throughout the province. This means actively supporting organizations in the communities where Hydro operates and its employees live.



### Hydro Pledges Support for Seniors

A key area of focus for Hydro's Community Investment Program is safety and health. At a safety and health seniors fair in St. John's in December, Hydro formed a five-year partnership with the Seniors Resource Centre (SRC) to help them expand and deliver their safety, health and wellness

initiatives for seniors. This partnership will play an integral role in continuing the great work of the SRC, particularly for its Peer Advocate Program, to increase the level of information and programs available around safety and wellness to seniors in the province. We have a growing senior population in Newfoundland and Labrador. It is estimated that within 10 years almost 50% of the province's population will be over the age of 50. The SRC, which is a charitable organization, has been assisting seniors in the province for over 20 years; promoting, enhancing and supporting the well-being and independence of older adults throughout the province.

Hydro's Community Investment Program is part of its commitment to help sustain vibrant and healthy communities. Corporate contributions are focused primarily around Safety and Health, and Environment and Conservation.

The company's long-term performance is related to its ability to make decisions that meet the needs of the people of Newfoundland and Labrador. In 2007, Hydro continued to seek feedback from customers, residents and community leaders. This feedback will be used to improve the company's performance and shape corporate decisions.

Hydro's presence in the community goes far beyond operational requirements. Every year the company supports hundreds of organizations

and special events. Hydro's connection with its communities grew this year through increased efforts to expand existing partnerships with organizations such as the Nature Conservancy Trust Foundation and the Community Food Sharing Association. New partnerships were also developed with the Newfoundland and Labrador Seniors Resource Centre and the Labrador Friendship Centre.

Hydro also awards scholarships to young people who are pursuing post-secondary academic studies. In 2007, Hydro awarded 26 scholarships to students throughout Newfoundland and Labrador.

The company believes its community investment partnerships are more than just financial commitments and throughout 2007, Hydro engaged employees in these partnerships. The company is proud of the ever-increasing number of employee volunteers who contribute to their communities. By partnering with employees through the Matching and Volunteer Contribution Program, Hydro reaches out to a broader range of community partners.

Hydro will continue to support community groups in their charitable efforts and focus its Community Investment Program on a small number of initiatives where the company can have the most meaningful impact over the long term. Hydro's commitment to safety, environment and conservation, and community investment will remain integral components of the company.

### Key Highlights:

- Selected the Newfoundland and Labrador Seniors Resource Centre as a safety and health partner.
- Supported over 25 organizations through the employee Matching and Volunteer Contribution Program.
- Sponsored Cabot Habitat for Humanity's Women Build 2007 by donating hard hats to keep volunteers safe while on the build site.





# management's discussion & analysis

## Management's Discussion and Analysis

The following discussion and analysis is the responsibility of management and is updated as of April 2, 2008. Newfoundland and Labrador Hydro (Hydro) 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 the company for the years ended and included in this Business and Financial Report, as well as the notes, for the respective years.

### SECTION 1: CORE BUSINESSES & MARKETS

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

Hydro generates, transmits and distributes electrical power and energy to utility, commercial, residential and industrial customers throughout the province. It also sells power to Hydro-Québec, both directly and through its subsidiary CF(L)Co. The combined installed generating capacity of the company and its subsidiaries, 7,307 megawatts (MW), makes it the fourth largest power utility company in Canada.

Hydro's business activities are grouped into three distinct business segments: Regulated Operations, Churchill Falls Operations and Other Energy Activities.

On October 11, 2007, the province proclaimed the Energy Corporation Act, creating a new Crown corporation to hold its investments in the energy sector. The province's energy corporation commenced operations on January 1, 2008. In 2008, Hydro, CF(L)Co, LCDC and GIPCo will become subsidiaries of the energy corporation and restructuring efforts are currently underway. As well, the operations included in Hydro's Other Energy Activities segment, which includes non-regulated electric utility activities, will be transferred to the energy corporation.

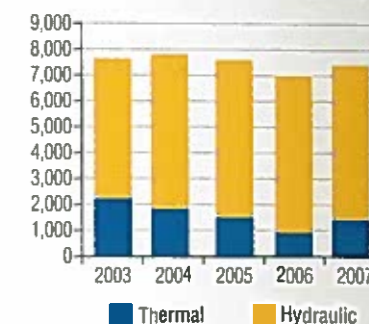
### REGULATED OPERATIONS

Hydro's Regulated Operations consist of sales of electricity to three primary customer groups:

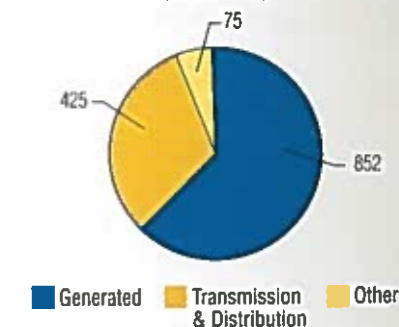
- Major industrial customers in the pulp and paper, mining and oil refining industries (four customers). Comprised 8.39% of regulated revenue (2006 - 11.6%).
- Over 35,000 residential and commercial customers in rural Newfoundland and Labrador. Comprised 14.1% of regulated revenue (2006 - 12.3%).
- Newfoundland Power, an investor-owned utility that distributes electrical power to 232,000 customers on the island portion of the province, with Hydro supplying 92% of their energy requirements. Comprised 77.1% of regulated revenue (2006 - 73.1%).

Hydro's regulated generating assets, with a total capacity of 1,635 MW, consist of nine hydroelectric plants, one oil-fired plant, four gas turbines and 25 diesel plants. In addition, Hydro has entered into a number of power purchase agreements with non-utility generators to supplement its own generation capacity.

Gross Energy Produced & Purchased by Hydro for Provincial Use (GWh)



Regulated Assets by Major Asset Group (\$ millions)





## Management's Discussion and Analysis

### CHURCHILL FALLS OPERATIONS

The Churchill Falls Generating Station, owned by CF(L)Co, is one of the largest underground powerhouses in the world with a rated capacity of 5,428 MW. A power contract with Hydro-Québec dated May 12, 1969 provides for the sale of almost 90% of the energy from this facility until 2041, at rates specified in the power contract. Hydro owns 65.8% of CF(L)Co and purchases 300 MW, the maximum allowed under the power contract, to provide service to customers in Labrador. The excess is sold to Hydro-Québec through a recall power sales agreement. CF(L)Co also sells 225 MW to TWINCo to service the iron ore mining industry in Labrador.

CF(L)Co generates revenues from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC). The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of additional capacity to Hydro-Québec during the months of November through March, until the end of the power contract in 2041.

### OTHER ENERGY ACTIVITIES

The revenue and earnings in this segment are derived from sales to Hydro-Québec from the 300 MW power sales agreement discussed above, and from sales to two industrial customers in Labrador. In 2007, Hydro assumed ownership of the Menihék Generating Station from the Iron Ore Company of Canada (IOC) and entered into a 40-year power purchase agreement to supply electricity to Hydro-Québec.

Also included in this segment are activities related to the development of the hydroelectric potential of the 2,824 MW Lower Churchill Project, as well as other non-regulated business opportunities in the energy sector, including: oil and gas, wind generation, alternative energy, and research and development. When individual components in this business segment become sanctioned projects, or become significant in size, the company will consider the appropriateness of classifying them as individual business segments. It is anticipated that oil and gas will be reported as a separate segment in 2008.

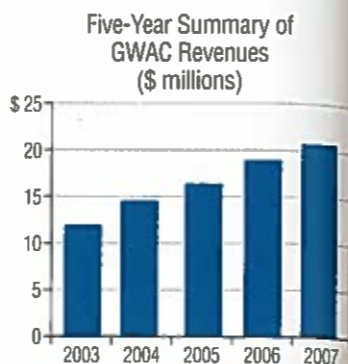
## SECTION 2: STRATEGY

Providing customers with safe, reliable, least-cost electricity has been the mandate of Hydro for over 50 years. In 2007, legislation was passed to create a new provincial energy corporation which will take a lead role in the development of provincial energy resources. The new corporation became operational effective January 1, 2008. This past year was pivotal for Hydro in preparing to expand in the energy sector beyond electricity generation, transmission and distribution.

Hydro's business strategy is to strengthen and ensure the integrity of its core business of power generation, transmission and distribution, as well as develop growth opportunities in energy-related activities, including the lower Churchill development. The company is also expanding into wind generation, oil and gas, alternative energy, and research and development. Hydro executes its strategy with an uncompromising commitment to safety, environmental stewardship, operational excellence, its people, and the communities in which it operates.

Hydro's goal of operational excellence focuses on delivering exceptional value to its customers. The company maintains five key pillars in its pursuit of operational excellence: safety, environment, reliability, customer service and cost management.

The company's focus is both short-term and long-term. Decisions that address immediate concerns as well as long-term issues help ensure there is adequate supply to meet the needs of existing



## Management's Discussion and Analysis

customers as well as the future needs of residents, businesses and industry. Hydro remains committed to reducing its reliance on non-renewable generation sources, and the promotion and implementation of energy efficiency and conservation.

### REGULATED OPERATIONS

Hydro is the primary generator and transmitter of electricity for use in the province. Hydro plays a key role in ensuring there is a safe, reliable and competitively-priced electricity supply available now and for future growth. Regulated property, plant and equipment has a net book value of \$1.3 billion in 2007. Much of this asset base was constructed in the 1960s and 1970s. With Hydro's generation, transmission and distribution assets aging, a key focus of the regulated operations strategy is to invest in asset upgrades and replacements in concert with the development of a comprehensive asset maintenance and management plan. This approach supports Hydro's strategy of managing its assets in a manner that minimizes total cost of ownership, operation and maintenance, while delivering safe, reliable service to its customers.

### CHURCHILL FALLS OPERATIONS

The Churchill Falls Generating Station produced over 33 terrawatt hours (TWh) of electricity in 2007. Under the terms of recall provisions of the long-term power contract with Hydro-Québec, 300 MW of power is available for use within the province. In 2007, this recall was sufficient to meet all residential, business and industrial requirements in Labrador, and allowed for the sale of approximately 1.5 gigawatt hours (GWh) to Hydro-Québec under the terms of a short-term recall power contract. Approximately 28.5 TWh were delivered to Hydro-Québec under the long-term power contract.

Hydro's strategy for Churchill Falls Operations focuses on operating, maintaining and investing, while maximizing the long-term value of the assets and meeting all contractual obligations. Key elements of the strategy are: maintaining safety leadership, environmental stewardship and reliability. Hydro is taking steps to ensure the continued performance of the facilities through long-term asset maintenance and management planning and strategic investment.

### OTHER ENERGY ACTIVITIES

The province's Energy Plan highlighted the role Hydro and the energy corporation will play in the development of key provincial energy resources. On behalf of the Shareholder, the Government of Newfoundland and Labrador, Hydro is actively pursuing development of the lower Churchill resource, entry into oil and gas activities and other energy-related business opportunities.

#### Lower Churchill

Hydro is investigating the potential of the lower Churchill hydroelectric development with the goal of providing information for the province to make a decision regarding sanction. This activity and analysis has focused on seven key areas:

- Project environmental assessment
- Engineering
- Project financing strategy
- Market analysis and access options
- Aboriginal Impacts and Benefits Agreement negotiations
- Project execution planning
- Operations planning

#### Business Development

The goal of Hydro's Business Development division is to grow a diversified and viable energy business. Hydro's strategy is to focus on three broad areas for growth: wind and renewables, oil and gas participation, and research and development. In 2007, Hydro continued to execute its strategy of wind energy development. Construction commenced on two 27 MW wind projects from which Hydro will purchase clean, renewable energy, reducing its reliance on thermal generation. Hydro also continues its assessment of development opportunities of large-scale wind in Labrador in conjunction with the Lower Churchill Project.



## Management's Discussion and Analysis

Hydro's near-term strategy for growth in the oil and gas sector is to obtain equity positions in various stages of the value chain. In 2007, Hydro entered the oil and gas area of the energy sector. This included negotiating an equity position in the White Rose Growth Project and entering into a Memorandum of Understanding (MOU) on an equity position in the Hebron development.

In the area of research and development, Hydro's main strategic focus continues to be on the successful development of the Ramea Wind-Hydrogen-Diesel Project. The project provides the potential for alternate renewable energy in isolated systems currently served with diesel generation.

### SECTION 3: PERFORMANCE AND PROSPECTS

#### FINANCIAL OVERVIEW

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

millions of dollars	2007	2006
Revenue	\$ 573.4	\$ 548.0
Expenses	491.8	478.0
Net Income	\$ 81.6	\$ 70.0

#### Key financial performance indicators:

Return on Equity (ROE)	13%	12.9%
Debt to Capital	65%	70%
Interest Coverage Ratio	1.81 times	1.66 times
Return on Capital Employed (ROCE)	9.2%	8.9%

#### Description of Performance Indicators

**Return on Equity** - Net Income/Average Equity.

**Debt to Capital** - Year end total debt balance expressed as a percentage of the total capital structure.

**Interest Coverage Ratio** - The extent to which income before financing charges is able to cover interest obligations.

**Return on Capital Employed** - Net Income plus Interest/Average Debt plus Equity (adjusted for assets under development).

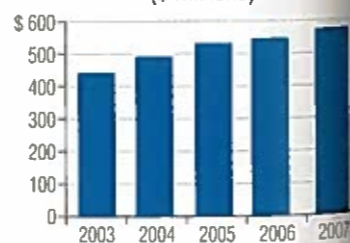
The improvement in the debt portion of the capital structure from 70% in 2006 to 65% in 2007 was mainly due to the continued suspension of dividend payments during 2007 and stronger earnings. ROCE improved largely due to the impact of new electricity rates in Regulated Operations implemented in early 2007.

#### BUSINESS SEGMENT REVIEW

Hydro reports its operational results in three business segments: Regulated Operations, Churchill Falls Operations and Other Energy Activities. These business segments are differentiated on the basis of regulatory status and management accountability. The 2007 financial results by business segment are shown in the following table:

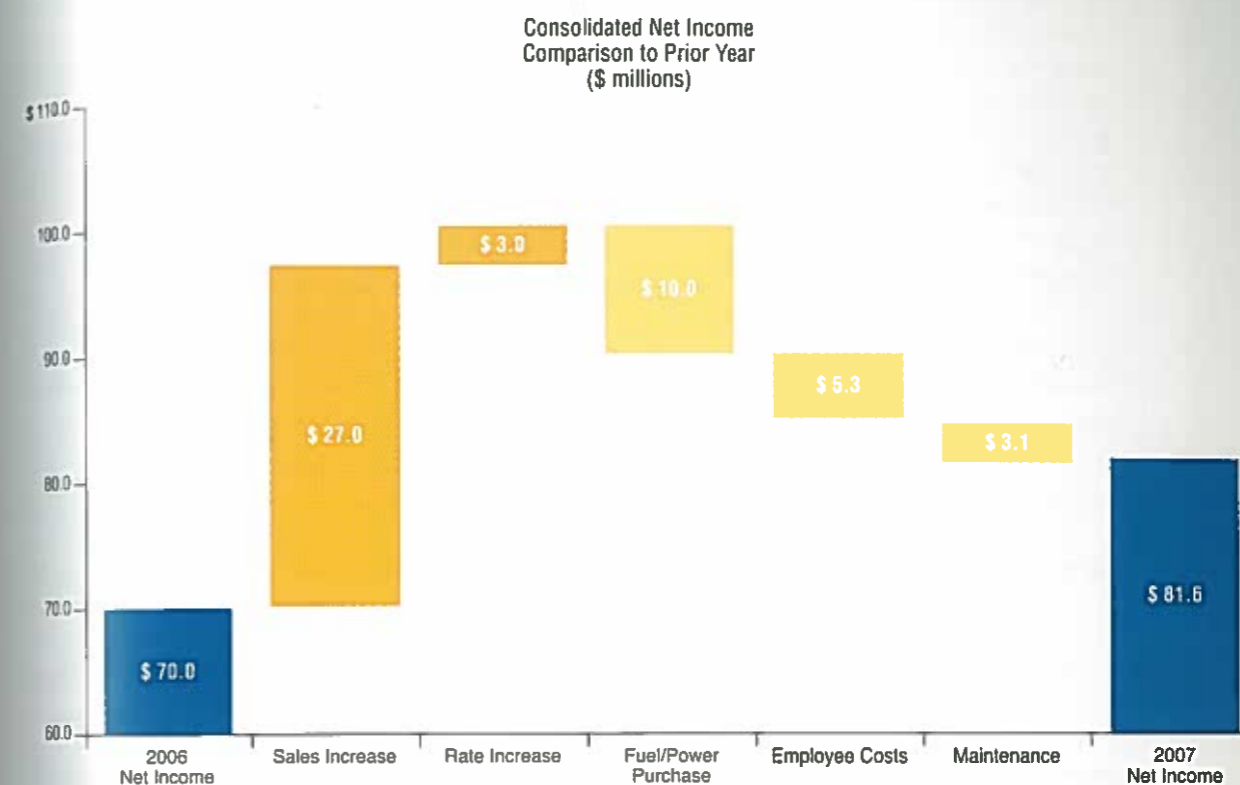
millions of dollars	2007	2006
Segment Income (Loss)		
Regulated Operations	\$ 2.9	\$ (6.9)
Churchill Falls Operations	25.1	26.4
Other Energy Activities	53.6	50.5
Total Income	\$ 81.6	\$ 70.0

Five-Year Summary of Revenues (\$ millions)



## Management's Discussion and Analysis

Factors contributing to the \$11.6 growth in net income in 2007 are shown in the following chart:



A detailed discussion of the factors contributing to the change in net income from 2006 to 2007 is contained in the discussion of segment results as follows:

#### Regulated Operations

**Factors that Shaped 2007 Regulated Operations Business Conditions:** Hydro's operations were impacted by many external factors, primarily the domestic economy, weather patterns and fuel costs. A favourable economic climate over the medium and longer term is instrumental to sustaining the electricity generation, transmission and distribution business.

In 2007, the provincial demand for electricity increased by 1% due to a return to near normal weather conditions which increased electricity demand related to electricity space heating. As well, mining activities at the Duck Pond Mine, and on the island in general, made positive contributions to electricity sales which were, in part, offset by the closure of a newsprint machine at the mill in Corner Brook in late 2007.

In 2007, energy production from the island's hydroelectric plants was lower than in 2006; which, combined with the overall increase in demand for electricity, resulted in an increase in the high-cost production from the Holyrood Generating Station. The resulting variation in fuel costs is deferred into the Rate Stabilization Plan (RSP) and will be collected from electricity consumers in the annual RSP rate adjustment.

The primary reason for an increase in regulated net income from a loss of \$6.9 million in 2006 to a net income of \$2.9 million in 2007 was the new rates set January 1, 2007. Hydro filed a General Rate Application (GRA) with the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) on August 3, 2006 which re-established rates based on 2007 cost levels, including an approved profit margin. There was, however, little or no increase in electricity rates for many customers throughout Newfoundland and Labrador for 2007 as a result of a negotiated settlement among the parties at the rate referral and the agreed-upon use of a positive balance in a rate stabilization reserve fund. As well, primarily due to a \$10.0 million payment into the RSP in 2006 by the Government of Newfoundland and Labrador to offset the accumulated debt in the RSP, Island Industrial Customers experienced a rate decrease of 18.3%. In December 2006, the PUB granted interim approval of rates effective January 1, 2007 with final approval provided in April 2007 (effective January 1, 2007).



## Management's Discussion and Analysis

Hydro's rates are based on an approved return on regulated equity of 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 ROE at a rate equal to the long-term marginal cost of debt. This return is the lowest approved ROE target of all utilities in Canada and when coupled with a highly leveraged capital structure (83% debt on a regulated basis in 2007), results in a limited ability for Hydro to withstand normal fluctuations in costs and revenues without seeking rate changes. There continues to be inherent risks of a low rate of return on Hydro's invested capital and the company is considering options to address this issue.

### Revenue:

millions of dollars	2007	2006
Newfoundland Power	\$ 339.8	\$ 304.5
Industrial Customers	36.7	48.4
Rural Customers	62.2	51.1
Other	2.0	12.5
Total Revenue	\$ 440.7	\$ 416.5

Sales to Newfoundland Power increased by 374 GWh, mainly as a result of colder weather, and accounts for approximately \$33.0 million of the increase in revenue from this customer. The balance was attributable to the modest rate increase which was implemented on January 1, 2007. While revenue increased, the impact on net income was mitigated by the fact that the increased sales were derived from increased generation at the Holyrood plant with a high marginal cost.

Sales to Industrial Customers increased by 22 GWh, but this volume increase was more than offset by the 18.3% rate reduction implemented on January 1, 2007, for an overall decrease in revenue from this customer class.

In 2007, sales to Rural Customers increased by approximately 51 GWh, primarily as a result of colder weather, accounting for the majority of the increase in revenue from these customers.

**Rate Stabilization Plan:** The RSP was established in 1986 to mitigate the impact of volatile fuel prices on electricity rates. The difference between the actual cost of fuel consumed to generate electricity and the cost upon which electricity rates are based (cost of service) accumulates in the RSP. Balances which accumulated prior to December 31, 2003 are being recovered from customers over a four-year period which commenced in 2004. As of December 31, 2007, \$12.1 million remains to be recovered. This balance will be fully recovered in 2008.

Balances accumulating in the RSP subsequent to 2003 are recovered in each following year, with the exception of the hydraulic variation, which is recovered or refunded at a rate of 25% annually. The hydraulic variation amount results from having higher than average water for hydroelectric production in recent years, reducing the need for thermal generation and related fuel costs. Rates are also adjusted annually based on forecast fuel prices through a "fuel rider". The rate adjustment for the "fuel rider" component and accumulated RSP balances becomes effective annually on July 1st for residential and commercial customers and on January 1st for industrial customers.

## Management's Discussion and Analysis

**Fuel:** Regulated Operations utilizes No. 6 fuel oil at the 490 MW Holyrood Generating Station and diesel fuel at its 25 diesel plants.

	2007	2006
No. 6 Fuel/RSP		
Consumption (millions of bbl)	2.0	1.3
Average purchase price (\$/bbl)	\$ 52.5	\$ 50.5
<i>millions of dollars</i>		
No. 6 Fuel/RSP	\$ 148.7	\$ 144.2
Diesel	10.5	10.4
Total Fuel Expense	\$ 159.2	\$ 154.6

No. 6 fuel increased from \$59.6 million in 2006 to \$138.9 million in 2007. The volume consumed at the Holyrood plant increased by 62%, or 787,000 barrels. Net production from the Holyrood plant in 2007 was 1,256 GWh, compared to 740 GWh in 2006, a 70% increase. Production from the plant in 2006 was exceptionally low as a result of higher water levels in the hydro reservoirs, favourable weather conditions and a reduction in load due to closure of a major industrial customer in late 2005. Overall, 2007 total fuel expense remained at approximately the 2006 level after accounting for the effects of the rate stabilization activity.

Diesel fuel expense increased by \$0.1 million, from \$10.4 million in 2006 to \$10.5 million in 2007.

**Power Purchased:** To supplement Hydro's electricity generation on the island, the company purchases power under long-term agreements with non-utility generators (see Note 17(e) to the Consolidated Financial Statements). The contracts, which are on a 'take or pay' basis, enable Hydro to reduce the amount of electricity produced at the Holyrood plant. In Labrador, it purchases nearly all of its requirements from CF(L)Co.

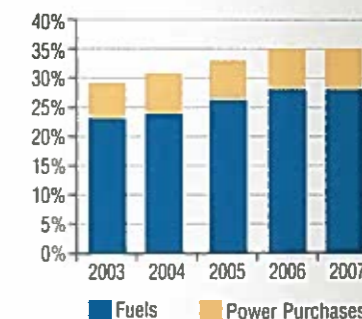
**Interest:** Interest expense decreased by \$5.3 million, from \$105.7 million in 2006 to \$100.4 million in 2007. This was primarily due to decreasing debt balances which have led to reduced interest expense and guarantee fees. Short-term debt balances were lower primarily as a result of continued suspension of dividend payments (further discussed in the Liquidity and Capital Resources section of this document).

**Operating Costs:** Regulated operating costs comprise 68% (2006 - 69%) of consolidated operating costs of \$143.1 million (2006 - \$130.4 million), as outlined below.

millions of dollars	2007	2006
Salaries	\$ 58.9	\$ 54.1
Maintenance	23.5	19.9
Other	15.1	15.5
Total Operating Costs	\$ 97.5	\$ 89.5

The increase in salaries of \$4.8 million in 2007 over 2006 arose primarily from negotiated salary increases of 1.5% and 3%, the former of which was retroactive to April 2006, as well as normal merit and promotional increases and a \$0.7 million increase in employee future benefits expense arising from an updated actuarial valuation. The increase in maintenance expense in 2007 primarily reflect a major overhaul of Unit #3 at the Holyrood plant, at a cost of \$2.1 million, plus an increase of \$0.9 million in the amortization of the asbestos abatement program at the plant.

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



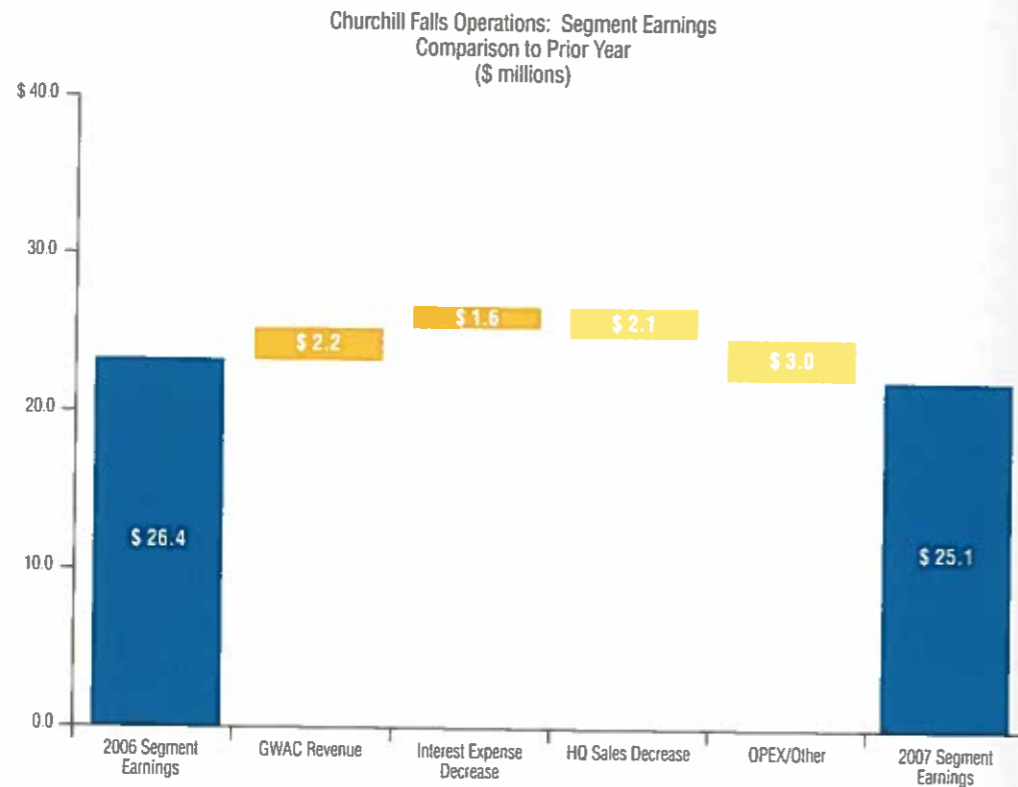


## Management's Discussion and Analysis

### Churchill Falls Operations

Hydro holds a 65.8% investment in CF(L)Co, with Hydro-Québec holding the remainder. As a result of a Shareholders' Agreement between Hydro, Hydro-Québec and CF(L)Co, in 1999, Hydro commenced accounting for its investment in CF(L)Co as a joint venture (see Note 1 to Consolidated Financial Statements) and includes 65.8% of the revenues, expenses, assets and liabilities of CF(L)Co.

In 2007, Churchill Falls Operations segment earnings were \$25.1 million, a decrease of \$1.3 million compared to 2006. Factors contributing to this decrease are depicted in the following chart:



Other activity for CF(L)Co during the year included the retirement in full of the First Mortgage Bonds (\$18.6 million) and payments on the General Mortgage Bonds (\$1.0 million). Hydro's share of these payments is 65.8%.

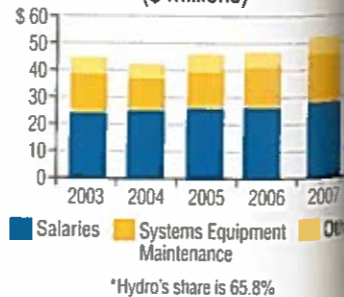
Subsequent to year end, on February 25, 2008, CF(L)Co completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.5% (6% net of subsidies), were retired and replaced with a 4.4% fixed rate credit agreement with the Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds.

### Other Energy Activities

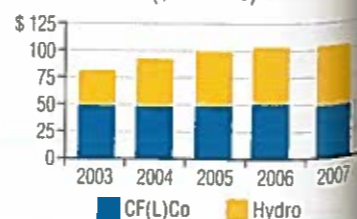
Other Energy Activities consist of four specific types of business activities:

**Export Sales:** Sale of excess recall power by Hydro to Hydro-Québec accounts for the majority of the net income in this business segment. In 2007, revenues from this activity were \$54.1 million (2006 - \$52.4 million) and net income was \$50.3 million (2006 - \$48.6 million). Additional energy was available in 2007 for sale to Hydro-Québec due to lower requirements to serve the Labrador Interconnected System primarily due to a labour disruption at a major industrial customer.

Five-Year Summary of Operating Expenses (CF(L)Co) (\$ millions)



Five-Year Summary of Export Sales (\$ millions)



## Management's Discussion and Analysis

The company will commence activities in 2008 to ensure arrangements for the sale of this power exist beyond the current contract term that expires at the end of the first quarter in 2009. In 2007, Hydro assumed ownership of the Menihek Generating Station from IOC and entered into a 40-year power purchase agreement to supply electricity to Hydro-Québec for its customers in the Schefferville region. The agreement includes a guaranteed rate of return and recall rights to the power if required.

**Electricity Sales to Mining Industry:** In addition to power supplied to the iron ore industry through TWINCo, Hydro also makes direct sales to the iron ore industry in Labrador. These direct sales in 2007 were \$4.4 million, compared to \$5.0 million in 2006, due to lower power requirements in 2007 as a result of a labour disruption at a major industrial customer.

**Lower Churchill Project:** Significant engineering activities were undertaken in 2007, including the execution of a field investigation program at the Gull Island site, marine surveys for the Strait of Belle Isle submarine HVDC crossing, as well as potential submarine HVDC crossings to Nova Scotia and New Brunswick. During 2007, all expenditures related to the development of the lower Churchill resource in Labrador (\$45.1 million) were capitalized, having no impact on net income. Major expenditure categories include:

- Project management, engineering, environment and impacts and benefits agreement (\$33.8 million).
- Project financing costs and interest expense (\$8.7 million).
- General administration (\$2.6 million).

The increase in segment assets reflects the continued pre-sanction investment in the Lower Churchill Project.

**Business Development:** Business development activities include costs incurred with respect to the pursuit of oil and gas investments, commercial ventures in Labrador wind, research and development and other business activities. In 2007, none of these activities were in a commercial stage and as a result, did not produce any revenues. Costs expensed and capitalized in 2007 were \$1.7 million and \$1.0 million, respectively. In August 2007, Hydro entered into a non-binding MOU with the partners of the Hebron Project to acquire a 4.9% interest in the properties, assets and undertakings of the project. In December 2007, the company entered into a binding Framework Agreement with the partners of the White Rose Growth Project to acquire a 5% working interest in the properties, assets and undertakings related to the planned oil field expansion. These transactions are expected to close in 2008.

This segment also includes LCDC and GIPCo. Both are inactive companies and had minimal transactions in 2006 and 2007.

All activities in this segment will be transferred to the energy corporation in 2008.

### 2008 FINANCIAL AND BUSINESS OUTLOOK

The company's financial condition is expected to improve with the continuing decline of the debt-to-capital ratio due to continued suspension of dividends.

It is anticipated that the energy corporation will fund its 2008 capital expenditures primarily through internally generated cash flow, a new \$150.0 million banking facility and short-term promissory notes. Hydro's 2008 funding requirements will be driven primarily by the refinancing of its \$200.0 million Series AA bond issue maturing on April 30, 2008. Hydro's short-term borrowing limit is presently set at \$300.0 million. Although there is expected to be sufficient capacity within Hydro's short-term borrowing limit to meet the refinancing requirement, the exclusive use of short-term borrowing could result in excessive levels of short-term debt relative to Hydro's total debt portfolio. Accordingly, Hydro may be obliged to arrange for a debenture issue during 2008.

The approved 2008 capital budget for the Regulated Operations and Churchill Falls Operations are \$42.4 million and \$7.7 million, respectively. Future capital expenditure levels for the oil and gas investments will be finalized upon preparation of development plans and capital cost estimates by the projects' partners. Future capital expenditure levels for the Lower Churchill Project will be determined based on finalization of the project configuration, including selection of customers, markets and transmission access routes.



## Management's Discussion and Analysis

CF(L)Co will make annual payments to accumulate a \$75.0 million Reserve Fund, as per the Shareholders' Agreement, to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. It is anticipated that CF(L)Co will have sufficient cash flow from operations to fund both the 2008 \$17.0 million Reserve Fund payment and 2008 estimated capital expenditures. Hydro's share of this commitment is 65.8%.

The energy corporation will also continue to analyze and assess other investment opportunities in 2008. Should these opportunities develop further, financing considerations and options will be addressed. Depending on the size of the investments, a decision whether additional borrowing is required will be made.

### FINANCIAL CONDITION REVIEW

Total assets were \$2,286.3 million at December 31, 2007, up \$54.0 million or 2.4% over December 31, 2006. Total liabilities decreased by \$49.4 million from December 31, 2006 to \$1,608.5 million at December 31, 2007. Total shareholder's equity increased by \$103.4 million to \$677.8 million over the same period.

#### Assets

There were a number of contributing factors to the increase in assets. Sinking funds increased by \$34.7 million due to a valuation gain of \$19.5 million and a \$15.2 million increase in investments and interest earnings. Accounts receivable increased by \$8.2 million and the first payment to the Reserve Fund of \$11.1 million was completed during the year. These increases were offset by a decrease in regulatory assets, primarily the continued collection of the long-term receivables. Hydro invested \$86.5 million in capital during 2007, compared to \$60.9 million in 2006. The increase primarily relates to higher expenditures on the Lower Churchill Project in 2007. Additions to property, plant and equipment were, in part, offset by amortization of \$50.7 million.

millions of dollars	2007	2006
Capital Expenditures		
Regulated Operations	\$ 36.0	\$ 41.6
Churchill Falls Operations	4.8	4.6
Other Energy Activities	45.7	14.7
Total	\$ 86.5	\$ 60.9

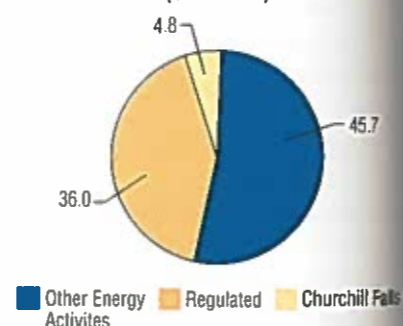
#### Liabilities

The decrease in liabilities of \$49.4 million was primarily attributable to a reduction in short-term borrowings of \$51.8 million as a result of the suspension of dividend payments. This was partially offset by an increase in employee future benefit obligations of \$5.1 million.

#### Equity

Retained earnings increased at December 31, 2007 compared to December 31, 2006 due to net earnings for 2007 of \$81.6 million. Also contributing to this increase was the unrealized gain on the sinking fund investments of \$19.5 million, reflected in accumulated other comprehensive income.

2007 Total Capital Expenditures (\$ millions)



## Management's Discussion and Analysis

### LIQUIDITY AND CAPITAL RESOURCES

#### Sources and Uses of Cash

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

millions of dollars	2007	2006
Cash provided by (used in)		
Operating activities	\$ 175.8	\$ 176.9
Financing activities	(64.8)	(84.0)
Investing activities	(116.4)	(86.4)
Net (decrease) increase in cash	\$ (5.4)	\$ 6.5

Liquidity requirements can be met through a variety of sources, including cash generated from operations, short-term borrowings and issuance of long-term debt. Hydro's primary use of funds are operating expenses, capital spending, and interest and principal payments on its debt.

Cash used in financing activities decreased by 22.9%, or \$19.2 million, primarily as a result of the decision in 2006 to suspend dividends from March 2006 until March 2008. Cash used in investing activities increased by 34.7%, or \$30.0 million. This was as a result of greater additions to property, plant and equipment and required payments by CF(L)Co to the Reserve Fund.

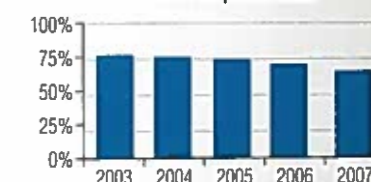
The company believes that internally generated cash flow, and borrowing under the energy corporation's loan facility, will be sufficient to meet its anticipated capital expenditures and other cash requirements in 2008.

### CAPITAL STRUCTURE

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

millions of dollars	2007	2006
Short-term debt	\$ 7.0	\$ 58.8
Current portion of long-term debt	209.1	22.5
Long-term debt (net of sinking funds)	1,036.0	1,277.6
Total Debt	\$1,252.1	\$1,358.9
Shareholder's Equity	\$677.8	\$574.4
Total Debt to Capital	65.0%	70.0%
Fixed Rate Debt as a percentage of total indebtedness	99.0%	96.0%
Dividend Payout Ratio	0.0%	4.0%

Five-Year Summary of Debt to Capital Ratio



Hydro uses a combination of short-term and long-term debt and equity instruments to finance its operations. A short-term promissory note program is utilized for its daily funding requirements. This program has an authorized limit of \$300.0 million and is guaranteed by the province. The current credit rating of R1(low) assigned to this program by Dominion Bond Rating Service (DBRS), combined with the provincial guarantee, allows Hydro to access short-term funds in the Canadian Money Market at attractive rates. Unsecured bank credit facilities are also in place in the amount of \$50.0 million for Hydro and \$10.0 million for CF(L)Co.

Capital markets are the principal source of longer-term funding for Hydro. Hydro's debenture issues are currently assigned A (low) credit rating by DBRS, and are also fully guaranteed by the province. Hydro's total borrowings outstanding, net of sinking funds and exclusive of borrowings pertaining to CF(L)Co, are limited by legislation to \$1,600.0 million. As of December 31, 2007, \$1,239.0 million was outstanding.

The operations of CF(L)Co are financed by cash from operations. The original capital investment in property, plant and equipment was financed by private placement and longer-term fixed rate debt instruments, some of which were denominated in U.S. dollars. During the year, debt pertaining to the First Mortgage Bonds (\$18.6 million) was retired in



## Management's Discussion and Analysis

full, with the remaining debt outstanding consisting of only the General Mortgage Bonds (GMB) which are secured by the Project Assets. Subsequent to year-end, these bonds (\$38.3 million) which bore an interest rate of 7.5% (6% net of subsidies) were refinanced and replaced with a 4.4% fixed rate credit arrangement with principal repayment terms the same as the GMBs. In March 2008, CF(L)Co used cash balances to repay \$10.0 million of this debt as provided for in the credit agreement.

The debt to capital ratio improved from 70% in 2006 to 65% in 2007. This improvement was primarily due to the suspension of the payment of common dividends until the end of March 2008. The Board of Directors, in conjunction with the Shareholder, determined that this reduction in dividends was desirable to improve the capital structure and facilitate Hydro's execution of its expanded mandate with respect to the Lower Churchill Project, wind, oil and gas and other investments.

For 2007, the consolidated weighted average cost of debt was 8%, the same as in 2006. With the anticipated completion of two oil and gas investments in 2008 and continued activity on the Lower Churchill Project, the company is preparing a financing plan that includes an anticipated \$150.0 million credit facility.

### OBLIGATIONS AND COMMITMENTS

Obligations and commitments for the five-year period of 2008 to 2012 are as follows:

millions of dollars	2008	2009	2010	2011	2012
Debt Repayments (1)	\$ 200.9	\$ 0.9	\$ 35.9	\$ -	\$ -
Sinking Fund Installments	8.2	8.2	8.2	8.2	8.2
Reserve Fund Payments (2)	11.2	11.2	5.3	5.3	5.3
Capital Projects (3)	16.8	-	-	-	-
Power Purchase Agreements (4)	37.3	56.0	59.0	65.8	66.5
Total	\$ 274.4	\$ 76.3	\$ 108.4	\$ 79.3	\$ 80.0

#### Notes:

- 1) Includes repayment of long-term debt. The repayments in 2008 include the maturity of a \$200 million ten-year bond.
- 2) In accordance with the Shareholders' Agreement, CF(L)Co is required to establish a \$75 million Reserve Fund for major repairs, which commenced with an initial payment on January 1, 2007. This item reflects Hydro's 65.8% share of the total Reserve Fund payments.
- 3) Includes \$15 million related to the Lower Churchill Project, of which \$9 million is for engineering services.
- 4) Hydro has entered into a number of power purchase agreements with remaining terms ranging from 15 to 26 years.

### RELATED PARTY TRANSACTIONS

Hydro purchases 300 MW of power from CF(L)Co to serve customers in Labrador with any excess being sold to Hydro-Québec. Purchases in 2007 were \$6.1 million, the same as 2006. Additionally, in the normal course of operations, Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. Fees paid by CF(L)Co to Hydro for these services amounted to \$2.2 million in 2007, compared to \$1.9 million in 2006.

Payments to the province are outlined in the table below:

millions of dollars	2007	2006
Debt Guarantee Fee	\$ 13.1	\$ 14.0
Water Rentals and Royalties (CF(L)Co)*	5.5	6.0
Total	\$ 18.6	\$ 20.0

\* Hydro's share is 65.8%

## Management's Discussion and Analysis

### SECTION 4: MANAGING RISK

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

#### OPERATIONAL RISK

This category of risk includes: major damage to critical assets; interruption of electrical service; and liability to third parties arising from property damage, bodily injury or death. To eliminate or lessen the impact of such risks, Hydro has developed regular maintenance, inspection and insurance programs covering all assets; initiated redundancy of critical assets; and completed loss analysis to produce effective loss prevention programs.

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 is utilized to develop renewal strategies resulting in the acquisition of comprehensive coverage at competitive cost.

Hydro is currently in the process of developing and implementing business continuity plans for events that could cause a complete disruption of essential service for an extended period of time. These plans will be used to identify and categorize potential catastrophic events and document procedures to ensure provision of minimal essential service for the duration of such events until full service can be restored. Responsible departments have been provided with a listing of identified events and a general format for the development of business continuity plans.

During the past year, Hydro implemented a Corporate Emergency Response Plan (CERP) and has designed and equipped a Corporate Emergency Response Centre at its head office. Training has been completed and exercises will be regularly undertaken to ensure those involved are prepared to deal with major emergencies.

Hydro also initiated a review of its maintenance practices to ensure the company plans its long-term maintenance to maximize plant availability in the most efficient manner. The review consists of an analysis of current maintenance practices compared to those used by other utilities and industries which have similar equipment. Hydro will use the results of this review to develop an optimized maintenance program. This study commenced in 2007 with a review of the gas turbine fleet and the Holyrood Generating Station, and will continue over a number of years with reviews of the remaining asset types in order of priority.

#### Safety

The provision of a safe and healthy workplace for all employees and contractors continues to be the company's number one priority. In keeping with the multi-year safety improvement strategy developed in 2006, there were a number of significant initiatives and achievements during 2007. A new collection and reporting process for unsafe conditions, near misses, and loss incidents - SWOP - was introduced, significantly enhancing the company's capability to analyze and correct health and safety deficiencies in the workplace.

#### Information Technology

Information technology affects all aspects of Hydro's operations. Major risk exposures in this environment are: the loss of processing capability due to hardware or software failure, the loss of communication capabilities across the wide area network and the threat of virus attacks on the company's computer system.

In the event of a major hardware failure, the company 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. Hydro maintains a Disaster Recovery Plan (DRP) that details the actual recovery procedures and processes. The DRP is updated and tested on a regular basis. The Energy Management System that controls Hydro's generation and transmission activities has a backup Energy Control Centre in a separate facility.



## Management's Discussion and Analysis

The threat of computer virus attacks on Hydro's computer system is 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 picking up malicious code from questionable sites. The company has also initiated increased security measures to align with Shareholder directives to all government departments and Crown agencies.

### Environmental

The number and diversity of environmental risks facing the company requires a structured and consistent management approach. Hydro has chosen the ISO 14001 Environmental Management System (EMS) standard developed by the International Organization for Standardization to drive continual improvement in mitigating environmental risks, while fulfilling its mandate to provide customers with safe, reliable and least-cost power. Targets for improvements to the company's EMS are established and monitored as part of its corporate goals and objectives.

Hydro mitigates environmental risk through adherence to the various principles of the EMS, which include regular internal environmental compliance audits, surveillance audits by an outside contractor, and recertification as ISO 14001 compliant.

### FINANCIAL RISK

Hydro operates in an environment with various forms of financial risk, including changes in interest rates and fluctuation in foreign currency exchange rates and commodity prices. Hydro utilizes a combination of financial instruments and portfolio management to manage these risks.

#### Interest Rates

Hydro manages its exposure to interest rates through ongoing benchmarking against key indices, an assessment of acceptable risk tolerance levels and the occasional utilization of derivative instruments to manage risk exposure within established parameters. Hydro has a diversified portfolio of fixed and floating rate debt which is formulated and managed with a view to an acceptable risk profile. Current guidelines, approved by the Board of Directors, limit floating rate exposure on an annual basis to a maximum of 7% of Hydro's total debt.

Of the total sinking fund investments, \$60.8 million is invested in Hydro's own debentures that were issued carrying the full guarantee of the province, with the remaining \$151.8 million in sinking fund investments in other entities. Authorized sinking fund investments of this nature are governed by the terms of each bond issue and, in general, are limited to obligations issued or guaranteed by the Government of Canada or any province of Canada.

If future interest rates change significantly, management will review the situation and take action as necessary to manage the company's exposure. Hydro has set current levels of exposure to floating rates based on sensitivity analyses performed in the context of historical movements in rates. In that respect, the company attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates. As the company continues to increase its energy investments in areas outside of its historical core businesses, it will review and revise the floating rate exposure policy as necessary.

#### Foreign Exchange and Commodity Prices

Hydro's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 oil for consumption at the Holyrood plant. During 2007, Hydro had total purchases of No. 6 oil of \$122.0 million (2006 - \$56.9 million). Since these purchases are denominated in U.S. dollars, a foreign exchange risk exists upon purchase of each fuel shipment.

Hydro's exposure is mitigated through the operation of the RSP. All variances in actual oil prices, as compared to that approved in Hydro's most recent Cost of Service used to set rates, are captured in the RSP and are either charged or refunded to customers through automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts as a means by which future exposure to exchange rates can be avoided. As at December 31, 2007, there were no forward contracts outstanding.

## Management's Discussion and Analysis

During the year, the CF(L)Co First Mortgage Bonds (FMB) that were denominated in U.S. dollars were fully repaid. There is no remaining long-term debt that is denominated in a currency other than Canadian dollars.

### Derivative Instruments

Periodically the company uses derivative instruments to manage its exposure to interest rate and foreign exchange risk. Hydro may enter into transactions that do not qualify for hedge accounting under Canadian Generally Accepted Accounting Principles (GAAP), but nevertheless are utilized to adjust risk exposure to acceptable levels. Transactions of this nature are recorded at their fair market value on Hydro's Consolidated Financial Statements and are marked to market each reporting period. Hydro also employs forward contracts for the purchase of U.S. currency in advance of a major currency requirement for a delivery of No. 6 oil for the Holyrood Plant.

### Regulatory

Most rates that Hydro charges for the provision of electrical service are established by the PUB. In addition to approving the costs that can be recovered in rates, the PUB establishes the return that can be earned in Regulated Operations. This return is currently based on an ROE established at 4.47%, which is substantially lower than other electric utilities in Canada. Management continues to believe that a return comparable to other electric utilities, commensurate with operational risk, is required in order to improve the financial condition of the regulated business and provide a fair return to the Shareholder.

### Growth Activities

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

### Internal Audit

The internal audit function assists the company in achieving its 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. During 2007, an independent quality assessment of Hydro's internal audit activity was conducted by the Institute of Internal Auditors. The Internal Audit department is "generally in conformance with international standards," which is the highest rating that the Institute provides.

## SECTION 5: CRITICAL ACCOUNTING ESTIMATES

Hydro'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 GAAP.

Significant accounting policies are contained in Note 1 to the audited Consolidated Financial Statements. Some of these policies involve critical accounting estimates requiring particularly subjective or complex judgments about matters 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. Hydro considers these estimates to be an important part of understanding the company's financial statements.

### EMPLOYEE FUTURE BENEFITS

The company provides pensions and other retirement benefits for most of its employees. Hydro believes the accounting estimates related to Hydro's employee benefit plan costs are critical accounting estimates because the derived estimates are based on the use of various key assumptions. Differences in actual results or changes in assumptions could materially affect Hydro'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 are reviewed by Hydro's actuaries.



## Management's Discussion and Analysis

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 10 to the Consolidated Financial Statements.

### ASSET RETIREMENT OBLIGATIONS

Hydro recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of a 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.

### SERVICE LIVES

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.

### IMPAIRMENT OF ASSETS

Hydro reviews the carrying value of its property, plants and equipment whenever events or changes in circumstances indicate that the expected undiscounted cash flows could be lower than the carrying value of the property and assets. 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, the demand and supply of electricity, the in-service dates of new generating stations, inflation, fuel prices, capital expenditures and station lives. The amount of future net cash flow that Hydro expects to receive from its property, plant and equipment could differ materially from the net book values recorded in Hydro's Consolidated Financial Statements.

### REGULATION

Generally, the accounting policies applicable to regulated operations 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, 2007, Hydro had \$86.4 million in current and long-term regulatory assets (2006 - \$102.3 million) and \$15.5 million in current and long-term regulatory liabilities (2006 - \$16.6 million). The nature of the company's regulatory assets and liabilities is described in Note 4 to the Consolidated Financial Statements.

## Management's Discussion and Analysis

### USEFUL LIFE OF CAPITAL ASSETS

Amortization is an estimate based primarily on the anticipated useful life of assets which reflects current facts and historical information. The company's consolidated property, plant and equipment represent approximately 80% of total consolidated assets as at December 31, 2007 (2006 - 80%). Amortization expense associated with property, plant and equipment was \$50.7 million during 2007 (2006 - \$48.5 million). Due to the size of the company's property, plant and equipment, changes in amortization rates can have a significant impact on amortization expense.

During 2005, pursuant to Order No. P.U. 7 (2002-2003), 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, 2004. Based on the results of this study, management estimated that accumulated amortization is approximately \$170.0 - \$180.0 million lower than it would otherwise be, and annual amortization expense is \$10.0 - \$11.0 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study is planned for 2008.

### CAPITALIZED OVERHEAD

As approved by the PUB, Hydro capitalizes overhead costs which 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 lives. In 2007, \$2.0 million (2006 - \$2.3 million) was allocated. 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.

## SECTION 6: ACCOUNTING CHANGES

### NEW ACCOUNTING POLICIES

Effective January 1, 2007, Hydro adopted new standards issued by the Canadian Institute of Chartered Accountants (CICA), specifically Section 1530 "Comprehensive Income"; Section 3855, "Financial Instruments - Recognition and Measurement"; Section 3861 "Financial Instruments - Disclosure and Presentation"; and Section 3865 - "Hedges". Under the new standards, a new statement for recognizing certain gains and losses - Other Comprehensive Income - has been introduced, providing for certain unrealized gains and losses arising from changes in fair value to be temporarily recorded outside the income statement. All financial instruments, including derivatives, are included on a company's balance sheet and measured in most cases at fair value.

The company has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available-for-sale
Reserve fund	Available-for-sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities



## Management's Discussion and Analysis

These new standards have been applied prospectively, without restatement of prior period amounts. Hydro recognized an increase to opening retained earnings of \$2.3 million upon adoption of these standards. This adjustment arose from the measurement of outstanding long-term debt at amortized cost using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of \$19.3 million.

### FUTURE ACCOUNTING CHANGES

The CICA has issued a number of new accounting standards, which are applicable for 2008 or subsequent fiscal years. The following provides more information on each new accounting standard:

**Capital Disclosures:** Section 1535, "Capital Disclosures", requires disclosure of the company's objectives, policies, and processes for managing capital, quantitative data about what the company regards as capital, whether the company has complied with all capital requirements, and if the company has not complied, the consequences of such non-compliance. The new accounting standard covers disclosure only and will have no effect on the financial results of the company.

**Inventories:** Section 3031, "Inventories", provides more guidance on the measurement and disclosure requirements for inventories than the previous standard, 3030 Inventories. Specifically, the new standard requires that inventories be measured at the lower of cost and net realizable value, and provides more guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. The company is assessing the effect of the new standard but does not anticipate any material effect on its financial results.

**Financial Instruments - Disclosures and Financial Instruments - Presentation:** These new standards, Sections 3862 and Section 3863 respectively, replace accounting standard 3861 "Financial Instruments - Disclosure and Presentation". Presentation requirements have not changed. Enhanced disclosure is required to assist users of the financial statements in evaluating the significance of financial instruments on the company's exposure to risks arising from financial instruments. The new accounting standards cover disclosure only and will have no effect on the financial results of the company.

**Goodwill and Intangible Assets:** Section 3064, "Goodwill and Intangible Assets", established standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to its initial recognition. The company is assessing the effect this new guidance will have on its financial results.

**International Financial Reporting Standards (IFRS):** The CICA has confirmed January 1, 2011 as the date that all publicly accountable entities in Canada should convert to IFRS. During 2008, Hydro and the energy corporation will be assessing the differences between its accounting policies and IFRS and will develop a convergence plan.

## Management's Discussion and Analysis

### SECTION 7: SUBSEQUENT EVENTS

In 2007, the province created a new Crown corporation to hold its investments in the energy sector. Hydro is in the process of transferring its non-regulated personnel and assets, including its investments in CF(L)Co, GIPCo and LCDC, to the new parent company. The segment information related to regulated operations in Note 16 is indicative of the operations that will remain in Hydro.

On February 25, 2008, CF(L)Co completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds in the amount of \$38.3 million, bearing an interest rate of 7.5% (6% net of subsidies), were retired and replaced with a 4.4% fixed rate credit agreement with the Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds. In March 2008, CF(L)Co utilized existing investments to prepay \$10.0 million of this debt as provided for under the credit arrangement, thereby realizing additional interest savings over the remaining term. As market conditions continue to develop, further opportunities for savings will be assessed, while having due regard for CF(L)Co's funding requirements.

### SECTION 8: FORWARD-LOOKING STATEMENTS

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 the company 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 rates, unexpected environmental conditions and government or regulatory policy changes. Hydro assumes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or any other reason.



## Management Report

The accompanying Consolidated Financial Statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

The 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 February 25, 2008. Financial information presented elsewhere in the Annual 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 Auditors' Report

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

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2007 and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these Consolidated Financial Statements present fairly, in all material respects, the financial position of the company as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian Generally Accepted Accounting Principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.



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

February 25, 2008





## Consolidated Balance Sheet

As at December 31 (millions of dollars)	2007	2006
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	7.2	10.0
Short-term investments	11.5	11.7
Accounts receivable	80.6	72.4
Current portion of long-term receivable (Note 5)	0.5	1.1
Current portion of regulatory assets (Note 4)	12.1	45.3
Fuel and supplies	69.7	54.4
Prepaid expenses	1.2	1.5
	<b>182.8</b>	<b>196.4</b>
Property, plant and equipment (Note 3)	1,825.7	1,791.5
Long-term receivables (Note 5)	23.3	19.2
Sinking funds (Notes 8 and 12)	151.8	117.1
Regulatory assets (Note 4)	86.4	102.9
Investments (Note 6)	5.2	5.2
Reserve fund (Note 17)	11.1	-
	<b>2,286.3</b>	<b>2,232.3</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
Current liabilities		
Bank indebtedness	9.1	6.5
Accounts payable and accrued liabilities	75.9	49.2
Accrued interest	30.7	30.8
Current portion of long-term debt (Note 8)	209.1	22.5
Current portion of regulatory liabilities (Note 4)	23.5	33.7
Promissory notes (Note 8)	7.0	58.8
	<b>355.3</b>	<b>201.5</b>
Long-term debt (Note 8)	1,187.8	1,394.7
Regulatory liabilities (Note 4)	15.5	16.6
Long-term payable (Note 9)	-	0.3
Employee future benefits (Note 10)	47.4	42.3
	<b>62.9</b>	<b>59.2</b>
Non-controlling interest in Lower Churchill Development Corporation	2.5	2.5
Shareholder's equity (Note 11)		
Share capital	22.5	22.5
Contributed capital	114.0	114.0
Retained earnings	521.8	437.9
Accumulated other comprehensive income (Note 12)	19.5	-
	<b>677.8</b>	<b>574.4</b>
Commitments and contingencies (Note 17)		
	<b>2,286.3</b>	<b>2,232.3</b>

See accompanying notes

On behalf of the Board:

  
**John Ottenheimer**  
 Director

  
**Gerald Shortall**  
 Director

## Consolidated Statement of Income and Retained Earnings

Year ended December 31 (millions of dollars)	2007	2006
Revenue		
Energy sales	546.5	522.9
Guaranteed winter availability	21.0	18.9
Rentals and royalties	0.3	0.3
Other	5.6	5.9
	<b>573.4</b>	<b>548.0</b>
Expenses		
Operations and administration	143.1	130.4
Fuels	159.2	154.6
Power purchased	38.4	38.8
Amortization	50.7	48.5
Interest (Note 14)	100.4	105.7
	<b>491.8</b>	<b>478.0</b>
Net income	81.6	70.0
Retained earnings, beginning of year	437.9	370.5
Add: adjustment to opening retained earnings (Note 2)	2.3	-
	<b>521.8</b>	<b>440.5</b>
Dividends	-	2.6
Retained earnings, end of year	<b>521.8</b>	<b>437.9</b>

See accompanying notes

## Consolidated Statement of Comprehensive Income

Year ended December 31 (millions of dollars)	2007	2006
Net income	81.6	70.0
Other comprehensive income		
Change in fair value of sinking fund investments	0.2	-
Comprehensive income	<b>81.8</b>	<b>70.0</b>

See accompanying notes



## Consolidated Statement of Cash Flows

Year ended December 31 (millions of dollars)	2007	2006
Cash provided by (used in)		
Operating activities		
Net income	81.6	70.0
Adjusted for items not involving a cash flow		
Amortization	50.7	48.5
Accretion of long-term debt	0.8	1.0
Loss on disposal of property, plant and equipment	1.0	1.6
Foreign exchange gain	(0.3)	-
Other	(0.1)	0.4
	133.7	121.5
Change in non-cash balances (Note 15)	42.1	55.4
	175.8	176.9
Financing activities		
Decrease in promissory notes	(51.8)	(92.0)
Long-term debt issued	-	225.0
Long-term debt retired	(13.1)	(215.1)
Dividends	-	(2.6)
Foreign exchange loss recovered	0.1	0.7
	(64.8)	(84.0)
Investing activities		
Additions to property, plant and equipment	(86.5)	(60.9)
Increase in sinking funds	(19.6)	(18.5)
Decrease (increase) in short-term investments	0.2	(5.6)
Additions to regulatory assets	-	(1.9)
Increase in reserve fund	(11.1)	-
Proceeds on disposal of property, plant and equipment	0.6	0.5
	(116.4)	(86.4)
Net (decrease) increase in cash	(5.4)	6.5
Cash position, beginning of year	3.5	(3.0)
Cash position, end of year	(1.9)	3.5
Cash position is represented by		
Cash and cash equivalents	7.2	10.0
Bank indebtedness	(9.1)	(6.5)
	(1.9)	3.5
Supplementary disclosure of cash flow information		
Income taxes paid	0.2	0.2
Interest income received	1.2	1.7
Interest paid	105.4	111.3

See accompanying notes

## Notes to Consolidated Financial Statements

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its principal activity is the development, generation and sale of electricity.

Gull Island Pond Corporation (GIPCo) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project). Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (Lower Churchill Development). Both GIPCo and LCDC are inactive.

Churchill Falls (Labrador) Company (CF(L)Co) is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW). Twin Falls Power Corporation (TWINCo) is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974. Hydro and its subsidiary and jointly controlled companies, other than TWINCo, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**

The Consolidated Financial Statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles. 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; litigation; environmental and asset retirement obligations; amortization; property, plant, and equipment; 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).

**Rates and Regulations (Excluding Sales by Subsidiaries)**

Hydro's revenues from electricity sales to most customers within the Province are subject to rate regulation by the PUB. As well, 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%. 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 financial statements are more fully disclosed in Note 4.

**Principles of Consolidation**

The Consolidated Financial Statements include the financial statements of Hydro and its subsidiary companies, GIPCo (100% owned) and LCDC (51% owned).

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

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec, in relation to CF(L)Co's General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.



## Notes to Consolidated Financial Statements

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

### Cash Equivalents and Short-term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments outstanding at December 31, 2007 bear interest rates of 4.12% to 5.00% (2006 - 4.28% to 4.35%) per annum.

### Fuel and Supplies

Fuel and supplies inventories are recorded at average cost.

### Property, Plant and Equipment

Property, plant and equipment are 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.

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 is reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and, consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

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 treated as a reduction to property, plant and equipment and the net property, plant and equipment are amortized.

### Hydro, GIPCo and LCDC

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

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

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 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.

## Notes to Consolidated Financial Statements

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

### CF(L)Co

CF(L)Co uses the group amortization method for certain property, plant and equipment, other than the generation plant, transmission and terminals, and service facilities.

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

Generation plant	
Hydroelectric	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

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

### Impairment of Long-lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.



## Notes to Consolidated Financial Statements

### Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec dated May 12, 1969 (Power Contract), provides for the sale of substantially all the energy from CF(L)Co until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Power Contract and decreases from the existing rate of 2.5425 mills per kWh to 2.0 mills per kWh upon renewal in 2016.

CF(L)Co receives revenues from Hydro-Québec under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

Also included in revenue are amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2006 - 7%).

### Foreign Currency Translation

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

- (a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.
- (b) At each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.
  - (i) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract. The First Mortgage Bonds were paid out during the year. CF(L)Co recovered a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract.

### Credit Risk

Hydro is exposed to credit risk associated with trade receivables. Although a significant portion of the total accounts receivable balance are due from one customer, management does not consider Hydro to be exposed to a material credit risk since that customer is another regulated utility.

### Employee Future Benefits

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

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

## Notes to Consolidated Financial Statements

### 2. NEW ACCOUNTING POLICIES

Effective January 1, 2007, Hydro adopted four new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA). Section 1530, "Comprehensive Income", introduces a new financial statement which shows the change in net assets of an enterprise attributable to transactions and other events from non-owner sources. Section 3855, "Financial Instruments - Recognition and Measurement", establishes standards for recognizing and measuring financial instruments, namely financial assets, financial liabilities and derivatives. The new standards prescribe how financial instruments are to be recognized on the balance sheet and the measurement of such amounts. Depending on financial instruments' classification, changes in subsequent measurements are recognized in net income or Other Comprehensive Income (OCI). Section 3861, "Financial Instruments - disclosure and presentation", establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Section 3865, "Hedges", specifies when and how hedge accounting may be applied. Hydro did not engage in any hedging relationships during this period.

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity, loans and receivables, available-for-sale, held-for-trading, or other liabilities. All financial instruments, including derivatives, are carried at fair value on the consolidated balance sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired.

The company has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available-for-sale
Reserve fund	Available-for-sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

These new standards have been applied prospectively without restatement of prior period amounts. Hydro recognized an increase to opening retained earnings of \$2.3 million upon adoption of these standards. This adjustment arose from the measurement of outstanding long-term debt at amortized cost using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of \$19.3 million.



## Notes to Consolidated Financial Statements

### 3. PROPERTY, PLANT AND EQUIPMENT

<i>millions of dollars</i>	Property, Plant and Equipment in Service	Contributions in Aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
<b>2007</b>					
Generation plant					
Hydroelectric	1,363.5	20.5	313.2	114.4	1,144.2
Thermal	244.2	0.8	188.3	0.8	55.9
Diesel	61.3	5.9	29.7	0.1	25.8
Transmission and distribution	767.2	60.7	229.2	0.8	478.1
Service facilities	22.0	-	11.1	-	10.9
Other	306.0	32.0	167.5	4.3	111.8
	<b>2,764.2</b>	<b>119.9</b>	<b>939.0</b>	<b>120.4</b>	<b>1,825.7</b>

<i>millions of dollars</i>	Property, Plant and Equipment in Service	Contributions in Aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
<b>2006</b>					
Generation plant					
Hydroelectric	1,362.0	20.5	300.8	70.4	1,111.1
Thermal	235.7	0.8	184.3	1.0	51.6
Diesel	59.7	6.1	27.9	1.0	26.7
Transmission and distribution	753.0	60.8	213.9	2.3	480.6
Service facilities	22.0	-	10.8	-	11.2
Other	289.9	29.1	155.5	5.0	110.3
	<b>2,722.3</b>	<b>117.3</b>	<b>893.2</b>	<b>79.7</b>	<b>1,791.5</b>

Included in the above amounts are CF(L)Co assets in service amounting to \$653.7 million (2006 - \$651.9 million) which are pledged as collateral for long-term debt.

## Notes to Consolidated Financial Statements

### 4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

<i>millions of dollars</i>	2007	2006	Remaining Recovery Settlement Period (years)
<b>Regulatory assets</b>			
Long-term receivable	12.1	63.1	0.5
Foreign exchange losses	73.3	75.5	35.0
Deferred regulatory costs	0.4	0.6	2.0
Deferred major extraordinary repairs	12.3	8.7	5.0
Deferred study costs	0.4	0.3	2.0
<b>Total regulatory assets</b>	<b>98.5</b>	<b>148.2</b>	
Less current portion	12.1	45.3	
	<b>86.4</b>	<b>102.9</b>	
<b>Regulatory liabilities</b>			
Rate Stabilization Plan	38.3	49.6	n/a
Deferred purchased power savings	0.7	0.7	20.0
<b>Total regulatory liabilities</b>	<b>39.0</b>	<b>50.3</b>	
Less current portion	23.5	33.7	
	<b>15.5</b>	<b>16.6</b>	

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. 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.

#### Rate Stabilization Plan and Related Long-term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to March 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and any remaining balances were transferred to the current plan. The recovery period for the utility customer will end on June 30, 2008. Any subsequent balances accumulating in the RSP, including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25 per cent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.



## Notes to Consolidated Financial Statements

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Generally Accepted Accounting Principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2007, \$31.5 million was recognized (2006 - \$3.9 million deferred) in the RSP and \$8.9 million (2006 - \$83.6 million) was recovered through rates and included in energy sales with a corresponding cost amortized in fuel expenses.

### 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, Generally Accepted Accounting Principles would require that Hydro include the losses in operating costs in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a 40-year period. This amortization, \$2.2 million annually, is included in interest expense (Note 14).

### Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the General Rate Application (GRA) and hearing to be amortized over a three-year period, which commenced in 2004. Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 GRA in the amount of \$0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, Generally Accepted Accounting Principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2007, \$0.2 million (2006 - \$0.7 million) of amortization was recognized in operations and administration expenses.

### 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 \$500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (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 will be recognized as a regulatory asset which will 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 2007, Hydro incurred \$2.0 million in expenses to repair a turbine at HTGS. These costs have been deferred as a major extraordinary repair. Subject to PUB approval, these costs will be amortized over a five-year period commencing in 2008. In the absence of rate regulation, Generally Accepted Accounting Principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube and turbine repairs in the year in which they were incurred. In 2007, \$2.1 million (2006 - \$1.1 million) of amortization was recognized in operating costs.

## Notes to Consolidated Financial Statements

### Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next GRA. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Generally Accepted Accounting Principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2007, \$0.2 million (2006 - \$0.2 million) was deferred in relation to these studies and \$0.1 million (2006 - nil) of amortization was recognized in operating costs.

### Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, Generally Accepted Accounting Principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

### 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. Since Hydro's AFUDC (7.6%) is lower than its cost of debt (8.0%), the amount capitalized is lower and interest expense is higher by \$0.3 million (2006 - \$0.3 million) than that which would be permitted in the absence of rate regulation (Note 14).

Hydro depreciates its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, pursuant to Order No. P.U. 7 (2002-2003), 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, 2004. Based on the results of this study, management estimated that accumulated amortization is approximately \$170-180 million lower than it would otherwise be, and annual amortization expense is \$10-11 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study is planned for 2008.

## 5. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits associated with an application for transmission service into Québec, bearing interest at prime until April 2007 and at one-year Guaranteed Income Certificate (GIC) rates thereafter.



## Notes to Consolidated Financial Statements

### 6. INVESTMENTS

<i>millions of dollars</i>	2007	2006
Lower Churchill Option	5.2	5.2

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

If LCDC is chosen as the ownership and financing vehicle for further development of the Lower Churchill Project, GIPCo's assets and the hydroelectric development rights to the lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the province (Option Agreement). The purchase price in respect of GIPCo's assets will be a maximum of \$100.0 million less \$5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of \$94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is \$10,000. The Option Agreement expires November 24, 2008.

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

### 7. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2007, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2007.

<i>millions of dollars</i>	2007	2006
Current assets	39.5	44.0
Long-term assets	328.9	325.1
Current liabilities	12.5	24.8
Long-term liabilities	36.6	37.4
Revenues	70.6	70.6
Expenses	51.0	48.7
Net income	19.6	21.9
Cash provided by (used in)		
Operating activities	40.4	33.6
Financing activities	(19.7)	(19.8)
Investing activities	(16.3)	(10.1)

## Notes to Consolidated Financial Statements

### 8. LONG-TERM DEBT

<i>millions of dollars</i>	Hydro	CF(L)Co	Total	Hydro	CF(L)Co	Total
	2007			2006		
Summary of long-term debt						
Long-term debt	1,359.4	37.5	1,396.9	1,365.6	51.6	1,417.2
Less current portion	208.3	0.8	209.1	8.3	14.2	22.5
	1,151.1	36.7	1,187.8	1,357.3	37.4	1,394.7

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

<i>millions of dollars</i>	2008	2009	2010	2011	2012
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	200.9	0.9	35.9	-	-
	209.1	9.1	44.1	8.2	8.2

Details of long-term debt are as follows:

Series	Interest Rate %	Year of Issue	Year of Maturity	<i>millions of dollars</i>	
				2007	2006
AA	5.50	1998	2008	199.9	199.6
V	10.50	1989	2014	124.4	124.7 (a)
X	10.25	1992	2017	149.0	149.4 (a)
Y	8.40	1996	2026	292.7	294.5 (a)
AB	6.65	2001	2031	307.1	306.6 (a)
AD	5.70	2003	2033	123.5	123.6 (a)
AE	4.30	2006	2016	223.3	223.2
Total debentures				1,419.9	1,421.6
Less sinking fund investments in own debentures				60.8	56.5
				1,359.1	1,365.1
Other				0.3	0.5
				1,359.4	1,365.6
Less current portion				208.3	8.3
				1,151.1	1,357.3

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

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which Management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2006 - 4.50% to 9.86%).



## Notes to Consolidated Financial Statements

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

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end, the promissory notes outstanding were at interest rates ranging from 4.30 to 4.45% (2006 - 4.25% to 4.55%).

Hydro maintains a \$50 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 also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate.

### CF(L)Co

<i>millions of dollars</i>	2007	2006
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (2006 - U.S. \$10.6)	-	12.4
7.875% Series B due December 15, 2007	-	1.1
General Mortgage Bonds		
7.500% due December 15, 2010	37.5	38.1
	37.5	51.6
Less current portion	0.8	14.2
	36.7	37.4

The First Mortgage Bonds, Series A and B, were repayable in fixed semi-annual and in contingent annual sinking fund installments. There were contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be an amount equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date with a final principal payment of \$35.9 million due in 2010. These bonds were subordinate to the First Mortgage Bonds (Note 19).

CF(L)Co maintains a \$10.0 million Canadian or U.S. equivalent unsecured operating credit facility with its banker. 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 provides coverage for overdrafts on CF(L)Co's bank accounts, with interest calculated at the prime rate.

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

### 9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, arising from the difference between energy deliveries and the Annual Energy Base (AEB) pursuant to the Power Contract, bears interest at 7.0% per annum and is repayable over a four-year period, which commenced in September 2004. The current portion of \$0.4 million (2006 - \$0.4 million) is included in accounts payable and accrued liabilities.

## Notes to Consolidated Financial Statements

### 10. EMPLOYEE FUTURE BENEFITS

#### Pension Plan

Employees participate in the province's Public Service Pension Plan, a multi-employer defined benefit plan. The employers' contributions of \$4.6 million (2006 - \$4.2 million) are expensed as incurred.

#### Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2007, cash payments to beneficiaries for its unfunded other employee future benefits was \$2.3 million (2006 - \$2.4 million). The most recent actuarial valuation was performed as at December 31, 2007.

<i>millions of dollars</i>	2007	2006
Accrued benefit obligation		
Balance at beginning of year	67.8	49.0
Current service cost	2.3	2.0
Interest cost	3.6	3.0
Actuarial (gain) loss	(2.8)	16.2
Benefits paid	(2.3)	(2.4)
Balance at end of year	68.6	67.8
Plan deficit at end of year	68.6	67.8
Unamortized actuarial loss	(20.9)	(25.2)
Unamortized past-service cost	(0.3)	(0.3)
Accrued benefit liability at end of year	47.4	42.3

<i>millions of dollars</i>	2007	2006
Components of benefit cost		
Current service cost	2.3	2.0
Interest cost	3.6	3.0
Actuarial (gain) loss	(2.8)	16.2
	3.1	21.2
Adjustments		
Difference between actual actuarial loss and amount recognized	4.3	(15.0)
Benefit expense	7.4	6.2



## Notes to Consolidated Financial Statements

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

	2007	2006
Discount rate	5.5%	5.3%
Rate of compensation increase	3.5%	3.5%

Assumed health care trend rates:

	2007	2006
Initial healthcare expense trend rate	8.0%	12.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	2011	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2007:

millions of dollars	Increase	Decrease
Current service cost	0.5	(0.4)
Interest cost	0.7	(0.4)
Accrued benefit obligation	11.9	(9.2)

### 11. SHAREHOLDER'S EQUITY

#### Share Capital

millions of dollars	2007	2006
Common shares of par value \$1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	22.5	22.5

#### Contributed Capital

millions of dollars	2007	2006
Lower Churchill Development Corporation	15.4	15.4
Muskrat Falls Project	2.2	2.2
Gull Island Project	96.4	96.4
	114.0	114.0

### 12. ACCUMULATED OTHER COMPREHENSIVE INCOME

millions of dollars	2007	2006
Adjusted opening balance arising from adoption of new accounting policies regarding financial instruments	19.3	-
Changes in fair value of sinking funds	0.2	-
Balance, end of year	19.5	-

There were no material changes in the fair market value of the reserve fund investments.

### 13. FINANCIAL INSTRUMENTS

#### Fair Value

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

## Notes to Consolidated Financial Statements

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars	2007		2006	
Long-term debt including current portion	1,396.9	1,731.2	1,417.2	1,781.9

### 14. INTEREST EXPENSE

millions of dollars	2007	2006
Gross interest		
Long-term debt	105.0	106.6
Promissory notes	0.9	5.1
	105.9	111.7
Accretion of long-term debt	0.8	1.1
Provision for foreign exchange losses	2.2	2.1
	108.9	114.9
Less		
Recovered from Hydro-Québec	1.0	1.1 (a)
Interest capitalized during construction	6.3	4.9
Interest earned	14.3	17.2
Net interest expense	87.3	91.7
Debt guarantee fee	13.1	14.0
Net interest and guarantee fee	100.4	105.7

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

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

### 15. CHANGE IN NON-CASH BALANCES

millions of dollars	2007	2006
Accounts receivable	(8.2)	(4.5)
Fuel and supplies	(15.3)	5.3
Prepaid expenses	0.3	0.8
Accounts payable and accrued liabilities	26.7	(9.8)
Regulated assets	49.7	39.1
Regulated liabilities	(11.3)	37.6
Accrued interest	(0.1)	1.3
Employee future benefits	5.1	3.8
Long-term receivable	(4.5)	(17.8)
Long-term payable	(0.3)	(0.4)
	42.1	55.4



## Notes to Consolidated Financial Statements

## 16. SEGMENT INFORMATION

Hydro operates in three business segments. Regulated operations encompass sales of power and energy to most customers within Newfoundland and Labrador while CF(L)Co operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Other energy activities are primarily engaged in energy project development and sales to markets outside the Province. 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 1.

millions of dollars	Regulated	Other	Churchill	Inter-	Total
	Operations	Energy Activities	Falls	Segment Eliminations	
<b>2007</b>					
Revenue					
External customers	440.7	58.5	70.7		573.4
Inter-segment		10.4	3.9	(10.8)	
Amortization	38.4	-	12.3		50.7
Interest	103.2	(5.0)	2.1	0.1	100.4
Net income (loss)	2.9	53.6	25.1		81.6
Assets	1,733.4	148.4	404.5		2,286.3
Capital expenditures	36.0	45.7	4.8		86.5
<b>2006</b>					
Revenue					
External customers	416.5	57.4	70.6		548.0
Inter-segment		10.1	3.9	(10.5)	
Amortization	36.6	-	11.9		48.5
Interest	102.4	(1.3)	4.5	0.1	105.7
Net income (loss)	(6.9)	50.5	26.4		70.0
Assets	1,732.8	97.5	402.0		2,232.3
Capital expenditures	41.6	14.7	4.6		60.9

At December 31, 2007, sales to Hydro's two largest customers amounted to 60% and 10% of total energy sales revenue (2006 - 61% and 14%). At December 31, 2007, approximately 60% (2006 - 57%) of the total accounts receivable balance outstanding is due from one customer.

## Geographic Information

Revenues by geographic area:

millions of dollars	2007	2006
Newfoundland and Labrador	445.1	426.8
Québec	128.3	121.2
	573.4	548.0

Substantially all of Hydro's assets are located in the province.

## Notes to Consolidated Financial Statements

## 17. COMMITMENTS AND CONTINGENCIES

- (a) Under the terms of a sublease with TWINCo, expiring on December 31, 2014, CF(L)Co is required to deliver to TWINCo, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls Generating Station and to maintain TWINCo's plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of TWINCo will revert to CF(L)Co and CF(L)Co is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

- (b) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, CF(L)Co commenced the creation of a \$75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to CF(L)Co's existing facilities and their replacement. CF(L)Co completed the first of six consecutive tranches on January 7, 2007. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2008	\$17.0 million
January 1, 2009	\$17.0 million
January 1, 2010	\$8.0 million
January 1, 2011	\$8.0 million
January 1, 2012	\$8.0 million

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. Hydro's share of this commitment is 65.8%.

- (c) Hydro has 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 Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be \$1.2 million (2006 - \$1.4 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately \$21.8 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

- (d) Outstanding commitments for capital projects total approximately \$16.8 million at December 31, 2007 (2006 - \$5.1 million).



## Notes to Consolidated Financial Statements

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

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	15 years
Hydroelectric	3 MW	1995	25 years
Hydroelectric	15 MW	1998	25 years
Hydroelectric	4 MW	1998	25 years
Hydroelectric	32 MW	2003	30 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2008	20 years

Estimated payments due in each of the next 5 years are as follows:

millions of dollars	2008	2009	2010	2011	2012
Power purchases	37.3	56.0	59.0	65.8	66.5

(f) Hydro has issued two irrevocable letters of credit, one in the amount of \$7.2 million to New Brunswick System Operator as credit support related to application for point-to-point transmission service. The second letter of credit has been issued 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. CF(L)Co has issued an irrevocable letter of credit, in the amount of \$1.0 million, to ensure compliance with a certificate of approval for the transportation of special/hazardous wastes, granted by the Department of Environment and Conservation.

### 18. RELATED PARTY TRANSACTIONS

The province, CF(L)Co, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

- (a) Hydro has entered into a long-term power contract with CF(L)Co for the purchase of \$6.1 million (2006 - \$6.1 million) of the power produced by CF(L)Co.
- (b) Under an agreement between Hydro and CF(L)Co, Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. For the year ended December 31, 2007, the fees paid to Hydro for these services amounted to approximately \$2.2 million (2006 - \$1.9 million).
- (c) 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 2007, Hydro paid \$1.2 million to the PUB (2006 - \$0.8 million, of which \$0.1 million was included in accrued liabilities reflected at December 31, 2006).
- (d) Under the terms and conditions of the CF(L)Co (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the Province annually.

## Notes to Consolidated Financial Statements

### 19. SUBSEQUENT EVENTS

- (a) Effective January 1, 2008, the Province created a new Crown corporation to hold its investments in the energy sector. Hydro is in the process of transferring its non-regulated assets and personnel, including its investments in CF(L)Co, GIPCo and LCDC, to the new parent company. The segment information related to regulated operations in Note 16 is indicative of the operations that will remain in Hydro.
- (b) On February 25, 2008, CF(L)Co completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.50% (6.00% net of subsidies), were retired and replaced with a 4.40% fixed rate credit agreement with the Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds.

### 20. COMPARATIVE FIGURES

Certain of the 2006 comparative figures have been reclassified to conform with the 2007 financial statement presentation. Specifically, deferred charges in the amount of \$3.4 million have been reclassified to debt as a result of the adoption of CICA Section 3855. In addition, a reclassification of investments of \$19.8 million is reported with the sinking funds as opposed to an offset against debt.



## Financial Statistics

Years ended December 31 (millions of dollars)	2007	2006	2005	2004	2003
<b>OPERATING RESULTS</b>					
Revenue					
Energy sales	546.5	522.9	510.4	474.0	424.5
Rentals and royalties	0.3	0.3	0.3	0.3	0.3
Guaranteed Winter Availability	21.0	18.9	16.4	14.6	11.9
Other	5.6	5.9	5.4	4.6	4.8
	<b>573.4</b>	<b>548.0</b>	<b>532.5</b>	<b>493.5</b>	<b>441.5</b>
Expenses					
Operations and administration	143.1	130.4	130.8	123.4	125.8
Fuels and power purchased	197.6	193.4	176.9	153.4	127.4
Amortization	50.7	48.5	47.0	45.8	45.0
Interest	100.4	105.7	105.9	103.7	99.3
	<b>491.8</b>	<b>478.0</b>	<b>460.6</b>	<b>426.3</b>	<b>397.5</b>
Income from operations	81.6	70.0	71.9	67.2	44.0
Write down of capital assets	-	-	-	-	130.9
Net income (loss) before non-controlling interest	81.6	70.0	71.9	67.2	(86.9)
Non-controlling interest	-	-	(12.3)	-	-
Net income (loss)	<b>81.6</b>	<b>70.0</b>	<b>71.9</b>	<b>67.2</b>	<b>(74.6)</b>
Contributions to net income (loss)					
Hydro	56.5	43.6	50.5	47.6	18.1
CF(L)Co	25.1	26.4	21.4	19.6	16.3
GIPCo	-	-	-	-	(96.3)
LCDC	-	-	-	-	(12.7)
<b>FINANCIAL POSITION</b>					
Total current assets	182.8	196.4	181.9	171.6	143.1
Total current liabilities	355.3	201.5	469.2	273.6	271.1
Net working capital	(172.5)	(5.1)	(287.3)	(102.0)	(128.0)
Property, plant and equip.	2,764.7	2,684.7	2,632.6	2,600.8	2,573.5
Accumulated depreciation	939.0	893.2	851.0	816.3	780.5
Property, plant and equip., net	<b>1,825.7</b>	<b>1,791.5</b>	<b>1,781.6</b>	<b>1,784.5</b>	<b>1,793.0</b>
Sinking funds	151.8	117.1	85.8	72.6	70.1
Other assets	126.0	127.3	154.8	187.9	225.1
Long-term debt	1,187.8	1,394.7	1,174.8	1,407.6	1,447.8
Other liabilities	65.4	61.7	53.1	44.5	34.5
Shareholder's equity	<b>677.8</b>	<b>574.4</b>	<b>507.0</b>	<b>490.9</b>	<b>477.9</b>
<b>STAFFING LEVELS</b>					
Full-time equivalents	1,173	1,147	1,144	1,149	1,190

## Operating Statistics

Years ended December 31	2007	2006	2005	2004	2003
<b>INSTALLED GENERATING CAPACITY (rated MW)</b>					
CF(L)Co	5,428	5,428	5,428	5,428	5,428
TWINCo	225	225	225	225	225
Hydro					
Hydraulic	958	939	939	939	939
Thermal	640	640	640	640	640
Diesel	56	56	56	57	57
Total	<b>7,307</b>	<b>7,289</b>	<b>7,289</b>	<b>7,289</b>	<b>7,289</b>
<b>ELECTRIC ENERGY GENERATED, NET (GWh)</b>					
CF(L)Co	33,254	34,663	33,563	32,800	33,457
Hydro - Hydraulic					
Hydraulic	4,689	4,802	4,770	4,726	4,321
Thermal	1,243	729	1,320	1,641	1,950
Diesel	44	42	43	47	45
Total	<b>39,230</b>	<b>40,236</b>	<b>39,696</b>	<b>39,214</b>	<b>39,773</b>
<b>ELECTRIC ENERGY SALES (GWh)</b>					
CF(L)Co	28,566	29,835	28,748	28,330	28,647
Hydro - Utility					
Utility	4,991	4,617	4,664	4,709	4,642
Rural	890	834	859	886	878
Industrial	1,136	1,145	1,685	1,842	1,711
Export	1,489	1,483	1,422	1,456	1,439
TwinCo Industrial	1,678	1,801	1,803	1,468	1,785
Total	<b>38,750</b>	<b>39,714</b>	<b>39,181</b>	<b>38,691</b>	<b>39,101</b>
<b>AVERAGE RATE (cents per kWh)</b>					
CF(L)Co	0.25	0.25	0.25	0.26	0.25
Hydro					
Utility	6.50	5.24	5.25	4.99	4.79
Rural	6.98	6.13	6.13	5.87	5.68
Industrial	4.21	3.71	3.43	3.24	3.14
Export	3.62	3.55	3.48	3.41	2.27
<b>TRANSMISSION LINES (km)</b>					
CF(L)Co	608	608	608	608	608
735 kV	431	431	431	431	431
230 kV	1,608	1,608	1,608	1,608	1,608
Hydro	1,500	1,500	1,500	1,500	1,500
230 kV	634	634	634	589	589
138 kV	634	634	634	589	589
69 kV	634	634	634	589	589
Total	<b>4,781</b>	<b>4,781</b>	<b>4,781</b>	<b>4,736</b>	<b>4,736</b>
<b>PEAK DEMAND (MW)</b>					
CF(L)Co	5,575	5,587	5,608	5,645	5,615
Hydro System	1,323	1,310	1,361	1,405	1,402

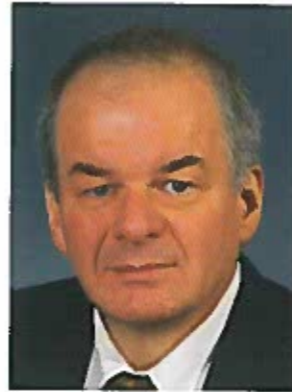


## Executive Leadership Team

**Ed Martin**  
President and  
Chief Executive  
Officer



**Andy MacNeill**  
Vice President  
Churchill Falls  
Operations



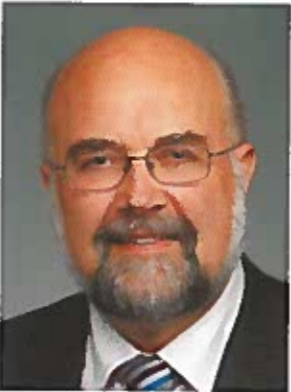
**Gilbert Bennett**  
Vice President  
Lower Churchill  
Project



**Gerard McDonald**  
Vice President  
Human Resources  
and Organizational  
Effectiveness



**Jim Haynes**  
Vice President  
Regulated  
Operations



**John Mallam**  
Vice President  
Engineering Services



**Jim Keating**  
Vice President  
Business  
Development



**Derrick Sturge**  
Vice President Finance  
and Chief Financial  
Officer



## Officers

### NEWFOUNDLAND AND LABRADOR HYDRO

**Dean MacDonald (1)**  
Chair

**John Ottenheimer (2)**  
Chair

**Ed Martin**  
President and  
Chief Executive Officer

**Gilbert Bennett**  
Vice President  
Lower Churchill Project

**Jim Haynes**  
Vice President  
Regulated Operations

**Jim Keating**  
Vice President  
Business Development

**Andy MacNeill**  
Vice President  
Churchill Falls Operations

**Gerard McDonald**  
Vice President  
Human Resources and  
Organizational Effectiveness

**John Mallam**  
Vice President  
Engineering Services

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer

**Mark Bradbury**  
Corporate Treasurer

**Wayne Chamberlain**  
General Counsel and  
Corporate Secretary

**Peter Hickman**  
Assistant Corporate Secretary

**Glenn Mitchell**  
Corporate Controller

### CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED

**Dean MacDonald (1)**  
Chair

**John Ottenheimer (2)**  
Chair

**Ed Martin**  
President and  
Chief Executive Officer

**Andy MacNeill**  
General Manager

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer

**Mark Bradbury**  
Corporate Treasurer

**Wayne Chamberlain**  
General Counsel and  
Corporate Secretary

**Peter Hickman**  
Assistant Corporate Secretary

**Glenn Mitchell**  
Corporate Controller

### TWIN FALLS POWER CORPORATION LIMITED

**Jim Haynes**  
President

**Andy MacNeill**  
General Manager

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer

**Mark Bradbury**  
Corporate Treasurer

**Peter Hickman**  
Corporate Secretary

**Glenn Mitchell**  
Corporate Controller

### GULL ISLAND POWER COMPANY LIMITED

**Dean MacDonald (1)**  
Chair

**Ed Martin**  
President and  
Chief Executive Officer

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer

**Mark Bradbury**  
Corporate Treasurer

**Wayne Chamberlain**  
Corporate Secretary

**Peter Hickman**  
Assistant Corporate Secretary

**Glenn Mitchell**  
Corporate Controller

### LOWER CHURCHILL DEVELOPMENT CORPORATION LIMITED

**Dean MacDonald (1)**  
Chair

**Chris Padfield**  
Vice Chair

**Ed Martin**  
President and  
Chief Executive Officer

**Mark Bradbury**  
Corporate Treasurer

**Wayne Chamberlain**  
Corporate Secretary

**Peter Hickman**  
Assistant Corporate Secretary

**Glenn Mitchell**  
Corporate Controller

(1) Resigned December 18, 2007  
(2) Appointed December 18, 2007

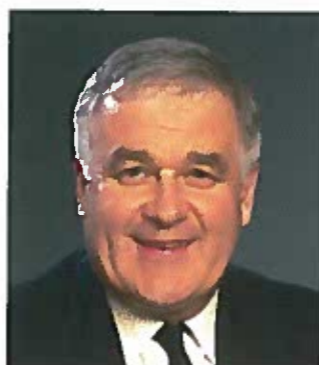


## Board of Directors

## NEWFOUNDLAND AND LABRADOR HYDRO



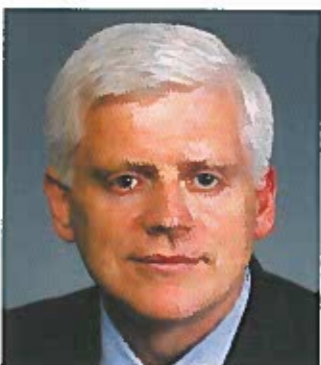
**Dean MacDonald, Chair**  
Resigned December 18, 2007  
Chief Executive Officer  
Persona Inc.



**John Ottenheimer, Chair**  
Appointed December 18, 2007  
Corporate Director



**Edna Turpin**<sup>2,3</sup>  
Consultant



**Ed Martin**  
President and  
Chief Executive Officer  
Newfoundland and  
Labrador Hydro



**Cathy Bennett**  
Owner/Operator  
Bennett Restaurants Ltd.



**Tom Clift**<sup>1,3</sup>  
Associate Dean  
Academic Programs  
Faculty of Business  
Memorial University



**Gerry Shortall**<sup>2,3</sup>  
Chartered Accountant  
Corporate Director



**Chris Kieley**  
Deputy Minister  
Department of Natural  
Resources  
Government of  
Newfoundland and  
Labrador



**Ken Marshall**<sup>1,2</sup>  
President  
Rogers Cable -  
Atlantic Region

1 - Compensation Committee 2 - Audit Committee 3 - Corporate Governance Committee

## Board of Directors

CHURCHILL FALLS  
(LABRADOR) CORPORATION  
LIMITED

**Dean MacDonald, Chair (1)**  
Chief Executive Officer  
Persona Inc.

**John Ottenheimer, Chair (2)**  
Corporate Director

**Richard Cacchione**  
President  
Hydro-Québec Production

**Gilbert Dalton**  
Executive Vice President and  
Chief Financial Officer  
Baine Johnston Corporation

**Albert Hickman**  
President  
Hickman Motors

**Ed Martin**  
President and  
Chief Executive Officer  
Newfoundland and Labrador Hydro

**Marie-José Nadeau**  
Executive Vice-President  
Corporate Affairs and  
Secretary General  
Hydro-Québec

**Bob Warr**  
Managing Director  
Nor-Lab Limited

**Bill Wells**  
Counsel  
Cox & Palmer

TWIN FALLS POWER  
CORPORATION LIMITED

**Wayne Chamberlain**  
General Counsel and  
Corporate Secretary  
Newfoundland and Labrador Hydro

**Stephen Fontanals**  
Controller  
Wabush Mines

**Jim Haynes**  
Vice President  
Regulated Operations  
Newfoundland and Labrador Hydro

**Andy MacNeill**  
Vice President  
Churchill Falls Operations

**Maurice McClure**  
General Manager  
Financial Planning and  
Cost Management  
Iron Ore Company of Canada

**Gerard McDonald**  
Vice President  
Human Resources and  
Organizational Effectiveness  
Newfoundland and Labrador Hydro

**Matthew Simpson**  
General Manager Primary Ore  
Iron Ore Company of Canada

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer  
Newfoundland and Labrador Hydro

**John Tuomi**  
Vice President Operations Services  
Wabush Mines

GULL ISLAND POWER  
COMPANY LIMITED

**Dean MacDonald, Chair (1)**  
Chief Executive Officer  
Persona Inc.

**Gilbert Bennett**  
Vice President  
Lower Churchill Project  
Newfoundland and Labrador Hydro

**Jim Haynes**  
Vice President Regulated Operations  
Newfoundland and Labrador Hydro

**Ed Martin**  
President and Chief Executive Officer  
Newfoundland and Labrador Hydro

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer  
Newfoundland and Labrador Hydro

LOWER CHURCHILL  
DEVELOPMENT  
CORPORATION LIMITED

**Dean MacDonald, Chair (1)**  
Chief Executive Officer  
Persona Inc.

**Gilbert Bennett**  
Vice President  
Lower Churchill Project  
Newfoundland and Labrador Hydro

**Ed Martin**  
President and  
Chief Executive Officer  
Appointed December 18, 2007

**Chris Padfield**  
Director  
Renewable and Electrical  
Energy Division  
Natural Resources Canada

**Derrick Sturge**  
Vice President Finance and  
Chief Financial Officer  
Newfoundland and Labrador Hydro

1) Resigned December 18, 2007  
2) Appointed December 18, 2007



## Corporate Governance

Hydro's Board currently consists of eight directors, comprised of six independent members drawn from the business community, the Deputy Minister of Natural Resources, and the company's President and CEO. In addition, effective October 11, 2007, the same directors became directors of the province's energy corporation.

The Board has a Corporate Governance Committee comprised of three independent directors. In 2006, the Committee initiated a comprehensive review of the corporate governance practices of the company. The objective of the review was to identify and implement best-practice corporate governance policies and procedures. The implementation of the results of this review was completed in 2007.

During 2007, the Board of Directors had four committees, all comprised of independent directors: Audit Committee, Corporate Governance Committee, Compensation Committee, and Safety, Health and Environment Committee. The corporate governance review resulted in new or revised mandates for the Board and the Committees.

In 2008, the company, in conjunction with the province's new energy corporation, will review the Board and Committee mandates and related policies to ensure alignment of roles and responsibilities with the Board of its new parent corporation.

The Audit Committee is comprised of three independent directors. The Chair of the Committee is a retired partner of a national accounting firm with significant experience in the financial reporting requirements of large, publicly-traded companies. The Audit Committee has adopted a number of policies similar to those of publicly-traded companies, including:

- A pre-approval process for non-audit services to be provided by the external auditor, including the identification of prohibited services.
- A policy regarding the hiring of current or former personnel of the external auditor in a financial reporting oversight role.
- Requirement that all members of the Audit Committee shall have basic financial literacy skills and that at least one member shall have accounting expertise at a level comparable to the complexity of the company's financial reporting issues.
- Procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters (whistle-blower policy).

The major activities of the Audit Committee during 2007 included the following:

- A major upgrade to the quality of the company's annual Consolidated Financial Statements and MD&A.
- An independent review of the company's internal audit department and review of plans to implement improvements.
- Initial planning activities for the conversion to International Financial Reporting Standards in 2011.
- Consultations with management and the company's external auditors to ensure appropriate accounting for financial instruments, other comprehensive income, and capitalization of costs for major new development projects.

## 2007 INSTALLED GENERATING CAPACITY



### 2007 GROSS ISLAND INTERCONNECTED ENERGY SUPPLY

<b>Hydraulic Generation</b>	GWh	<b>Power Purchases</b>	454
Bay d'Espoir	2,681	Percentage of Total Energy Supply	7%
Cat Arm	744		
Upper Salmon	603	<b>Thermal Generation</b>	
Hinds Lake	388	Holyrood	1,340
Granite Canal	247	Gas Turbine and Diesel	2
Paradise River	34		1,342
Mini Hydro	7		
	4,704		
Percentage of Total Energy Supply	72%	Percentage of Total Energy Supply	21%

### LEGEND

- Generating Station
- ▲ Diesel Plant
- Terminal Station
- ⚡ Wind Generation
- Transmission Lines**
- 735-kV
- 230-kV
- 138-kV
- 69-kV
- Low Voltage
- Customer-Owned





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Canada

[www.nlh.nl.ca](http://www.nlh.nl.ca)