2012 BUSINESS AND FINANCIAL REPORT

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Key Accomplishments at a Glance

Years ended December 31 (millions of dollars)	2012	2011
Revenues	**726.1**	714.1
Net income	**92.7**	128.8
Capital assets, net	**2,811.0**	2,413.7
Long-term debt	**1,125.9**	1,131.5
Shareholder's equity	**1,564.9**	1,429.7
Dividends	**-**	-
Capital expenditures	**477.4**	253.9
Debt to capital	**38.9%**	38.4%
Funds from operations to debt	**15.7%**	20.7%

SAFETY: TO BE A SAFETY LEADER

- Reported 7,400 safety-related observations through the Safe Workplace Observation Program.
- Delivered a BeSafe Safety Coaching workshop to over 600 employees.

ENVIRONMENT: TO BE AN ENVIRONMENTAL LEADER

- Completed 97% of environmental leadership targets, exceeding target of 95%.
- Lower Churchill Hydroelectric Generation Project released from environmental assessment.

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

- Hydro achieved 99.97% winter generation availability, exceeding target of 98%.
- Completed capital investments in Churchill Falls of nearly $55 million.
- Achieved approval of the Hebron Development Plan and Project sanction
- Achieved sanction of the Muskrat Falls Project.
- Created a 20-year capital plan for the Bull Arm Fabrication site.
- Advanced the Labrador Industrial Rates Policy in collaboration with the Department of Natural Resources.
- Delivered 99.8% of available recall energy to market.

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

- Reached 10,000 On the Spot peer recognitions since the program launched in 2008 (over 3,000 in 2012), and presented 11 employees with prestigious President's Awards.
- Achieved 82% participation rate in employee engagement survey compared to AON Hewitts database average participation rate of 57%.

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

- Awarded over $50,000 in scholarships to Newfoundland and Labrador youth.
- Over 220 employees volunteered over 440 hours with community groups and charities throughout the province during Nalcor's annual Acts of Kindness Week.

OUR VALUES: OPEN COMMUNICATION • ACCOUNTABILITY • SAFETY • HONESTY AND TRUST • TEAMWORK • RESPECT AND DIGNITY • LEADERSHIP

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

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Message from the Chair

Employees and the Board are guided by the company's vision to build a strong economic future for successive generations of Newfoundlanders and Labradorians.

Anchored by a strong vision, Nalcor Energy is progressing with its plans to manage the province's energy resources for the benefit of future generations. As we achieved significant milestones in 2012, we look back on the progress we've made to bring us to this stage.

Our success is rooted in the foundation we've built in our existing business, and in the principles and values of the company that guide how we conduct our business. The Board of Directors has put in place a strong governance structure to oversee Nalcor's business activities, assume an appropriate level of risk, and ensure a strong financial position for the benefit of our Shareholder, the Government of Newfoundland and Labrador.

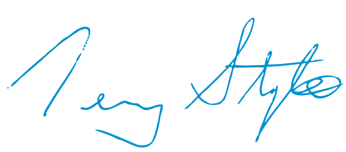
In December 2012, we celebrated an important moment in this province's history – the sanction of the Muskrat Falls Project. As we move forward with the construction phase of this project, we remain grounded in our commitment to safety and asset management philosophy.

We also continue to benefit from our partnerships in the offshore. The sanction of the Hebron project in December 2012 is an important driver of continued growth in this province. Nalcor's offshore exploration strategy will also play an important role in attracting future development to strengthen the economic prosperity of Newfoundland and Labrador.

Our focus over the next several years is to stay the course. The company continues a relentless dedication to safety through all our lines of business. With aging assets in our operating businesses, our continued commitment to asset management is essential. While we move in the right direction with growth opportunities, these fundamental aspects of our strategy are in place to provide an appropriate balance with existing operations.

The Board of Directors is confident in the direction and operational plans of the company, which are being executed at the right time by highly skilled and experienced employees. To continue to meet customer expectations for safe, reliable operations and least-cost electricity, we remain focused on a growing capital program to support asset renewal and continued safe operations.

In 2012, I was pleased to assume the role of Chair of the Board of Directors. It's an exciting time for Nalcor Energy. Employees and the Board are guided by the company's vision to build a strong economic future for successive generations of Newfoundlanders and Labradorians. We're poised for success through alignment with and continued support from our Shareholder.



TERRANCE STYLES
CHAIR, BOARD OF DIRECTORS

Message from the CEO

Our operations and engineering are anchored in a strong asset management strategy that is critical to growing our business and managing this province's energy resources.

In 2012 we reached an important stage in the history of our company and the province with the sanction of the Muskrat Falls and Hebron projects. Coupled with our advancement of seismic exploration activities in offshore oil and gas these accomplishments marked an important step towards our vision of building a strong, sustained economic future for Newfoundlanders and Labradorians.

As we embark on these developments that will benefit current and future generations through employment and economic returns, I'm compelled to reflect on the work that has taken place over the past several years to enable us to progress towards our vision.

Above all, our priority throughout the company is our safety journey. Seven years ago, we set out with a goal to achieve world-class safety performance. An important piece of that goal is to use our processes and tools to do all our work safely, but this road we are on also takes hard work, relentless drive and commitment. I'm confident in our ability to maintain and grow our strong safety culture given the full support and engagement of our Board of Directors, Leadership Team, Union leadership and all our employees. Collectively, our minds are focused on the same goal and together, we'll continue to press for zero harm.

Our operating electricity businesses are managing assets well over 40 and 50 years old. To ensure continued reliability and safe operations for the future, we must continue our commitment to company-wide standards around asset management Our operations and engineering are anchored in a strong asset management strategy that is critical to growing our business and managing this province's energy resources. Our focus remains on ensuring maintenance and renewal of our existing aging infrastructure is completed in a methodical, planned approach.

In 2012, we welcomed several new members to our Board of Directors. Our new and existing board members have a range of backgrounds and experience essential to ensuring our company is effectively managing its existing businesses and growth opportunities.

Through careful and strategic planning, we've evolved our risk profile and taken measures to ensure we're in a solid financial position for the future. This is important as we engage in a growing capital investment program and secure beneficial growth opportunities in the energy sector.

We're proud of our many accomplishments over the past year. Our investments in the energy sector secure a sustainable, clean energy supply to meet our province's future electricity needs. We have a strong team of skilled and capable individuals, whose passion for exceptional project management, execution and safety position us well for the new challenges ahead.

ED MARTIN
PRESIDENT & CHIEF EXECUTIVE OFFICER

Corporate Profile

NEWFOUNDLAND AND LABRADOR HYDRO

Hydro provides safe, reliable and cost-effective electricity supply to meet current electricity needs and future growth. Hydro generates and delivers electricity in Newfoundland and Labrador to utility, industrial, residential and commercial customers in over 200 communities across the province.

CHURCHILL FALLS

Churchill Falls is one of the largest underground hydroelectric powerhouses in the world with a rated capacity of 5,428 megawatts. The Churchill Falls generating station provides clean, renewable electricity to millions of consumers throughout North America.

OIL AND GAS

Nalcor is a partner in three developments in the Newfoundland and Labrador offshore: the Hebron oil field, the White Rose Growth Project and the Hibernia Southern Extension. Oil and Gas is also executing a comprehensive exploration strategy to accelerate the discovery of new resources in the offshore.

Nalcor's business includes the development, generation, transmission and sale of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication and energy marketing.

LOWER CHURCHILL PROJECT

The hydroelectric potential of Muskrat Falls and Gull Island make the lower Churchill River the best undeveloped hydroelectric source in North America. Together they have a combined capacity of more than 3,000 megawatts. The Muskrat Falls Project was sanctioned in 2012 and is currently under construction.

BULL ARM FABRICATION

The Bull Arm Fabrication site is a world-class facility spanning over 6,300 acres with capabilities for steel fabrication and concrete construction, outfitting installation, at-shore hook-up and deep water commissioning. The site is leased to ExxonMobil Canada Properties for the Hebron project until 2017.

ENERGY MARKETING AND OTHER ENERGY ACTIVITIES

Nalcor is involved in energy marketing and other energy activities, including non-regulated electricity generation, wind energy, and research and development. Nalcor's energy marketing portfolio will grow over the coming years and currently includes recall power not required by Hydro.

The road to safety excellence

Nalcor Energy's goal is to make sure every employee gets home safe every day.

To achieve world-class safety performance, the company is implementing sound processes, tools and training and instilling a safety culture throughout all its operations.

Over the last decade, there has been a strong improvement in safety performance. Since 2002, there has been a 65 per cent reduction in lost-time injury rates. Since tracking of high-potential incidents began in 2008, the rate has dropped 64 per cent and the severity of injuries has also dropped significantly. These statistics reinforce the commitment of workers and the company to safety and a safety mindset.

A critical aspect of achieving zero harm is for all employees to focus on their behaviours and attitudes towards safety. Since the introduction of the Safe Workplace Observation Program in 2007, reporting of conditions and incidents has increased by 54 per cent indicating a positive shift towards identifying safety related observations and correcting them to prevent incidents.

In 2012, Nalcor achieved zero lost-time injuries and zero medical treatment injuries in many areas of the company. A small segment of the company has experienced a higher number of

incidents. Going forward, the company has a focused plan in place to provide additional support in their safety journey.

Nalcor continues to move forward with perseverance and determination on its safety journey.

Stewards of the provincial electricity system

In our rivers, through our skies, across our oceans...

A cornerstone of the company's electrical business is to provide safe, reliable and least-cost electricity to people, businesses and industry.

To facilitate its commitment to customers, a robust asset management program is in place and is reviewed regularly to ensure strategic investments are made on the right assets at the right time to achieve maximum value. In 2012, Hydro invested $77 million in the provincial electricity grid, including major upgrades on generating units at the Bay d'Espoir hydroelectric plant and the Holyrood Thermal Generating Station.

At the Churchill Falls Generating Station, a key focus remains on asset renewal. The company has a long-term plan in place for the 40-year old facility to ensure quality operations of this important electricity asset in the province. The replacement of the facility's transformer fleet and major switchyard components, and refurbishment of components of the 11 underground generating units are examples of significant capital programs currently underway at the generating station.

Nalcor is also managing non-regulated hydroelectric facilities for the benefit of Newfoundlanders and Labradorians. Power from the Exploits Generation and Star Lake facilities is providing benefit for island electricity consumers. The Menihek hydroelectric operation in Labrador achieved electricity sales of 42 gigawatt hours in 2012, resulting in total revenue generation of $1.4 million.

Nalcor's asset management framework is grounded in its long history and expertise in the electricity business, and reflected throughout Nalcor's lines of business. As capital investments increase over the next few years to maintain continued reliability of its existing electricity assets, the company is also ensuring strategic plans are in place to manage and integrate new developments such as the Muskrat Falls Project.

WITH ELECTRICITY ASSETS AND EMPLOYEES SPANNING THE PROVINCE, A COMMITMENT TO SAFETY AND ASSET MANAGEMENT IS CRITICAL TO SERVING CUSTOMERS EFFECTIVELY.

Managing our resources for growth and prosperity

Nalcor Energy pursues strategic development and investment opportunities in the energy sector with the aim of securing a sustainable economic future for Newfoundlanders and Labradorians.

SECURING OUR ENERGY FUTURE

In December 2012, the Muskrat Falls Project was sanctioned by Nalcor Energy and partner, Emera Inc.

Electricity generated at Muskrat Falls will power homes and businesses in the province with clean, renewable energy for generations to come. This new source of power will help meet the province's growing energy demands with stable electricity rates.

The federal loan guarantee from the Government of Canada is an important benefit for electricity consumers in the province. In addition, Nalcor's partnership with Emera Inc. to construct the Maritime Link will help leverage financial opportunities for export sales of surplus electricity. The ongoing support of the provincial government is key to the success of this project, both by providing equity investments and by enabling critical legislation to move this project forward.

PURSUING OPPORTUNITIES IN THE OIL AND GAS INDUSTRY

In 2012, the Hebron project was sanctioned. Nalcor is a partner in this project and Nalcor's investment is expected to contribute $2.7 billion to Nalcor over the life of the project. In addition, working interests in the Hibernia Southern Extension and the White Rose Extension Project are important components to Nalcor's role in managing the province's energy future.

Nalcor is advancing its strategy to invest and promote the province's oil and gas potential through existing partnerships in the offshore and

...there's a change happening in the way we think about energy...

increasing exploration interest by the world's oil and gas industry.

In early 2013, Nalcor announced the discovery of three new offshore basins in the Labrador Sea. The discovery was a direct outcome of a partnership with global seismic companies TGS and PGS to conduct a multi-client 2D seismic survey of offshore Newfoundland and Labrador. Strategic investment to better understand the province's resource potential is a step towards achieving increased exploration interest to advance the oil and gas industry.

MANAGING THE LARGEST INDUSTRIAL FABRICATION SITE IN ATLANTIC CANADA

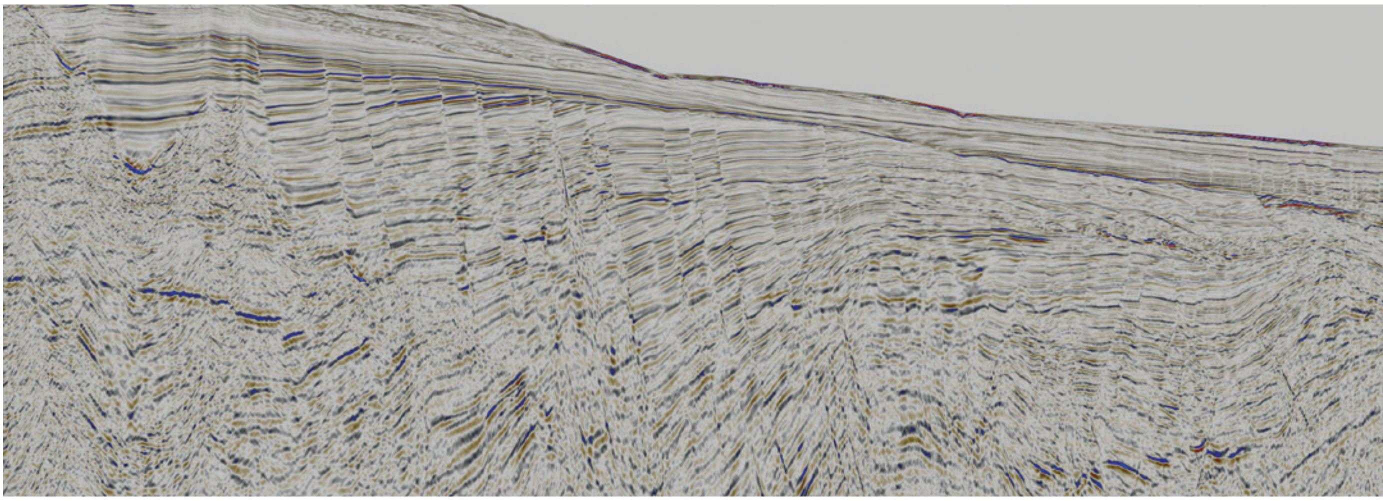
The Bull Arm site is a world-class fabrication facility and an important asset for industrial development in Newfoundland and Labrador. In 2012, Nalcor managed a successful leasing relationship with the tenants of Bull Arm, ExxonMobil Canada Properties for construction of the Hebron Project. Activity at the site is well underway with the start of construction on the gravity-based structure in 2012.

By supporting the Hebron project and developing a long-term strategy for the site, the company will advance its goal to establish a safe and competitive operation with a sustained workforce for the benefit of future generations.

POSITIONED FOR LONG-TERM ENERGY MARKETING NEEDS

Nalcor is continuing efforts to advance its energy marketing strategy to maximize the value of its current assets and position Nalcor for longer-term energy marketing success. The company is taking a strategic view to managing the province's own energy, and making the necessary investments today for long-term economic value. Efforts to grow the company's energy marketing capability will be a key enabler to facilitate obtaining maximum value from the Lower Churchill Project and other energy projects.

Nalcor is continuing to advance renewable energy research and development. The company is making progress on the Wind-Hydrogen-Diesel Energy Project in Ramea as a means to offset the diesel requirements of an electrically-isolated community. A key component of this project is to optimize operation and efficiencies of the equipment and determine the market potential of the system.



Commitment to environmental stewardship

As a leader in the development of Newfoundland and Labrador's energy resources, Nalcor Energy is dedicated to environmentally-sound practices.

In 2012, Nalcor achieved 97 per cent of its environmental targets, including ISO 14001 Certified Environmental Management Systems (EMS) initiatives for Hydro and Churchill Falls. Significant progress was also made to expand EMS to Nalcor's other operations.

Hydro continued its joint energy efficiency initiative, takeCharge, with Newfoundland Power, providing information, tools, and rebate programs to assist Newfoundlanders and Labradorians to use energy wisely.

In 2012, Hydro launched the Isolated System Energy Efficiency Program and directly installed more than 1,300 energy efficiency kits in Labrador communities achieving 1.7 gigawatt hours/year of savings. The Isolated System Business Efficiency Program was also launched, providing technical support and financial incentives of up to 80 per cent of capital costs to commercial customers to retrofit their

properties to be more energy efficient and resulted in three megawatt hours of savings in 2012.

Always on in our communities

…leading the way is Nalcor Energy.

Nalcor Energy and Hydro employees have the energy and commitment to help create healthy, vibrant communities. In 2012, employees raised almost $88,000 through the company's matching and employee volunteerism programs to contribute to local charity organizations in the province.

Hydro provides ongoing financial support and partnership with over 250 community and charitable organizations in Newfoundland and Labrador. In 2012, Hydro demonstrated further support of Ronald McDonald House Newfoundland and Labrador (RMHNL) as a presenting sponsor of the Red Shoe Crew Walk for Families which was held in 27 communities around the province. Through contributions to RMHNL's capital campaign, fundraisers and the Employee Giving Program, Hydro and its employees contributed $84,000 in 2012 to support RMHNL.

Nalcor also held its second annual Acts of Kindness Week in April 2012. Over 220 employees volunteered 440 hours, demonstrating the company's commitment to giving back to communities.

EMPLOYEES THROUGHOUT NALCOR'S LINES OF BUSINESS STRIVE TO BE COMMITTED AND INNOVATIVE IN THEIR ACTIVITIES RELATED TO CORPORATE SOCIAL RESPONSIBILITY.

Management's Discussion & Analysis

The following discussion and analysis is the responsibility of management and is as of April 23, 2013.

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

Certain statements in this MD&A are forward-looking statements subject to risks and uncertainties. Statements containing words such as "could," "expect," "may", "anticipate," "believe," "intend," "estimate," "plan" and similar expressions constitute forward-looking statements. These statements are based on certain factors and assumptions, including: foreign exchange rates, expected growth, results of operations, performance and business prospects and opportunities. While Nalcor considers these factors and assumptions to be reasonable based on information currently available, they may prove to be incorrect. A number of factors could cause actual results to differ materially from those in the forward-looking statements, including, but not limited to: fluctuations in supply and demand in electricity markets, changes in capital markets, changes in currency and exchange rates, unexpected environmental conditions, fluctuations in future fuel and electricity prices, changes in oil reserves and government or regulatory policy changes. Nalcor assumes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or any other reason.

At Nalcor Energy, our foundation is rooted in our base business - the generation and transmission of electrical power.

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SECTION 1: CORPORATE OVERVIEW AND STRATEGY

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

Nalcor's legal structure at December 31, 2012 included the entities listed below:

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

HYDRO REGULATED

Hydro Regulated generates, transmits and distributes electricity to customers throughout Newfoundland and Labrador. Hydro

Entity Name	Description of Interest
Newfoundland and Labrador Hydro (Hydro)	Wholly-owned subsidiary
Nalcor Energy - Oil and Gas Inc. (Oil and Gas)	Wholly-owned subsidiary
Nalcor Energy - Bull Arm Fabrication Inc. (Bull Arm Fabrication)	Wholly-owned subsidiary
Gull Island Power Corporation (GIPCo)	Wholly-owned subsidiary
Labrador Island Link General Partner Corporation	Wholly-owned subsidiary
Labrador Island Link Holding Corporation	Wholly-owned subsidiary
Churchill Falls (Labrador) Corporation (Churchill Falls)	65.8% owned joint venture of Hydro
Twin Falls Power Corporation (Twin Falls)	33.3% owned joint venture of Churchill Falls
Lower Churchill Development Corporation (LCDC)	51% owned subsidiary of Hydro
Labrador Island Link Limited Partnership[1]	100% owned subsidiary of Nalcor

[1] Nalcor's ownership changed to 65% in February 2013.

Regulated's mandate is to ensure a safe, reliable and least-cost electricity supply is available to meet current demand and future growth. Hydro Regulated's operations consist of sales of electricity to three primary customer groups:

- Newfoundland Power, an investor-owned utility that distributes electricity to over 251,000 customers on the island portion of the province, with Hydro Regulated supplying 93% (2011 - 93%) of its energy requirements comprising 81.7% of regulated revenue (2011 - 81.2%).
- Over 37,000 residential and commercial customers in rural Newfoundland and Labrador comprising 14.8% of regulated revenue (2011 - 15.0%).
- Major industrial customers primarily in the pulp and paper, mining and oil refining industries comprising 3.5% of regulated revenue (2011- 3.8%).

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

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

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

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

CHURCHILL FALLS

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

Nalcor, through its subsidiary, Hydro, holds a 65.8% interest in Churchill Falls, with Hydro-Quebec holding the remainder. In 1999, as a result of the Shareholders' Agreement between Hydro, Hydro-Quebec and Churchill Falls, Hydro commenced accounting for its investment in Churchill Falls as a joint venture (see Note 2 to the Consolidated Financial Statements) and includes 65.8% of the revenues, expenses, assets and liabilities of Churchill Falls in the consolidated results.

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

The strategy for Churchill Falls focuses on safely operating and maintaining its assets to optimize long-term value while meeting all contractual obligations.

OIL AND GAS

Oil and Gas is a partner in three developments in the Newfoundland and Labrador offshore – 4.9% working interest in the Hebron oil field, the province's fourth offshore oil project which was sanctioned for development on December 31, 2012; 5.0% working interest in the White Rose Growth Project, which produced first oil from the North Amethyst field in May 2010; and 10.0% working interest in the Hibernia Southern Extension Project, which produced first oil in June 2011.

Oil and Gas has also developed a multi-year strategy that outlines priorities for increasing exploration interest in the province. This strategy aims to encourage more exploration drilling by international exploration and production companies through Nalcor's investment in the provision of high-quality seismic data. Oil and Gas has also entered into a strategic partnership in a seismic survey of offshore Newfoundland and Labrador. Nearly 30,000 km of high-quality seismic data was acquired in 2011 and 2012. This is part of a multi-year program that will significantly add to the offshore 2D seismic data set in Newfoundland and Labrador.

ENERGY MARKETING

The revenue and earnings in this segment are derived primarily from sales of electricity available from the 300 MW recall energy block. This electricity is sold to export markets in eastern Canada and the northeast United States as well as to the iron ore industry in Labrador. To access export markets, Nalcor has service agreements with Hydro-Quebec for 265 MW of long-term electricity transmission capacity from Labrador through Quebec to the Canada-United States border. This segment also includes the operations of the Menihek Generating Station which supplies power to Hydro-Quebec for its customers in the Schefferville region.

MUSKRAT FALLS PROJECT

The Muskrat Falls Project, which was sanctioned on December 17, 2012, is the first phase of the Lower Churchill Project. The Project includes an 824 MW hydroelectric facility at Muskrat Falls on the lower Churchill River in Labrador, over 1,500 km of associated transmission lines in Newfoundland and Labrador linking the island of Newfoundland to Labrador, and the Maritime Link between the island of Newfoundland and Nova Scotia. The hydroelectric facility and the transmission lines in the province will be constructed by Nalcor and the Maritime Link will be constructed by Emera Inc.

The development of the Muskrat Falls Project will provide a clean, renewable source of electricity to meet the province's

growing energy demands. It will provide Newfoundland and Labrador homes and businesses with stable electricity rates well into the future, and will be a valuable power-producing asset for the province for more than 100 years. This project has been identified as the lowest-cost alternative to meet the province's growing need for electricity and will provide jobs and benefits for the people of Newfoundland and Labrador. In addition to providing long-term stable electricity rates, the development will help Canada's efforts to reduce greenhouse gas emissions.

BULL ARM FABRICATION

Bull Arm Fabrication is Atlantic Canada's largest industrial fabrication site. The site, which has unobstructed, deep water access to the Atlantic Ocean, generates revenue through leasing arrangements with large construction projects. This site is currently under lease until 2017 for the construction of the Gravity Base Structure (GBS) platform and other construction and fabrication activities related to the Hebron project. Nalcor is currently developing a long-term strategy for the site to ensure the success of Bull Arm Fabrication once the current lease expires.

CORPORATE AND OTHER ACTIVITIES

This segment includes corporate support functions, business development activities and certain non-sanctioned development projects including Phase 2 of the Lower Churchill Project (Gull Island).

SECTION 2: PERFORMANCE

FINANCIAL HIGHLIGHTS

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

millions of dollars	2012	2011
Revenue	$ 726.1	$ 714.1
Expenses	633.4	585.3
Net income	$ 92.7	$ 128.8
Key Financial Performance Indicators:		
Cash flow from operations	$ 185.9	$ 219.2
Return on equity	6.2%	9.6%
Total debt to capital	38.9%	38.4%

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

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

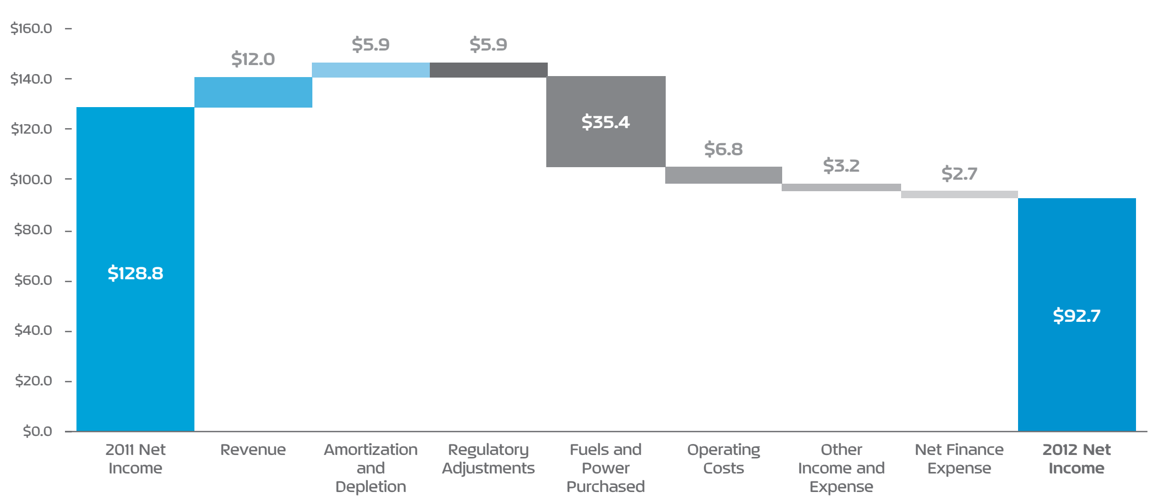
Total debt to capital – Total debt (promissory notes, long-term debt including current portion less sinking funds), divided by debt plus shareholders' equity.

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

Overall net income for 2012 was $92.7 million, a decrease of $36.1 million from the $128.8 million in 2011. The primary reason for the decrease in net income was a decrease in Energy Marketing earnings of $25.9 million due to a downturn in the North American electricity markets and a decrease in Oil and Gas earnings of $6.4 million due to decreased oil production. Variances by major category are outlined below and discussed in more detail in the Business Segment Review.

- **Revenue**: Total revenue was $726.1 million, an increase of $12.0 million in 2012 compared to 2011 revenue of $714.1 million, primarily due to an increase in Hydro Regulated electricity sales.
- **Fuels**: Fuel expense was $182.4 million, an increase of $27.5 million in 2012 compared to $154.9 million in 2011, primarily due to an increase in fuel prices.
- **Power purchased**: Power purchases were $60.8 million, an increase of $7.9 million in 2012 over 2011 costs of $52.9 million, primarily due to an increase in purchases from the Exploits hydroelectric assets.
- **Operating costs**: Operating costs were $206.9 million, an increase of $6.8 million over 2011 costs of $200.1 million primarily due to an increase in salaries and related benefit costs of $7.1 million.
- **Amortization and depletion**: Amortization and depletion was $79.3 million, a decrease of $5.9 million over 2011 of $85.2 million. The decrease was primarily the result of lower depletion expense of $11.0 million in Oil and Gas due to decreased production levels. This decrease was partially offset by an increase in amortization due to increasing levels of investment in property, plant and equipment in Hydro Regulated.

NALCOR ENERGY - NET INCOME COMPARISON 2012 VS. 2011 | $ MILLIONS



- **Net finance expense**: Net finance expense includes interest income and expense, foreign exchange gains and losses, and accretion expense on long-term debt and long-term liabilities. In 2012, net finance expense was $73.6 million, an increase of $2.7 million compared to $70.9 million in 2011. This increase is primarily related to accretion expense related to long-term payables recognized in 2011 under the Upper Churchill Redress Agreement (UCRA).
- **Other income and expense**: Other income and expense includes losses on disposal of property, plant and equipment, other asset removal costs, insurance proceeds and gains or losses on derivative contracts. In 2012, other income and expense was $0.4 million, an increase of $3.2 million from a gain of $2.8 million in 2011 primarily due to asset disposal costs in Hydro Regulated.
- **Regulatory adjustments**: Regulatory adjustments consist of Hydro Regulated deferrals of current year expenditures and amortization of previously deferred costs as approved by the PUB. In 2012, regulatory adjustments were $30.0 million, an increase of $5.9 million compared to $24.1 million in 2011 primarily due to deferrals of revenue and fuel expenses in the Rate Stabilization Plan (RSP).
- **Capital expenditures**: Capital expenditures were $477.4 million, an increase of $223.5 million over 2011 levels as depicted below:

millions of dollars	2012	2011
Hydro Regulated	$ 77.6	$ 62.3
Churchill Falls[1]	30.1	25.6
Oil and Gas	88.8	63.3
Muskrat Falls Project	275.3	89.2
Corporate and Other Activities	5.6	13.5
	$ 477.4	$ 253.9

[1] Reflects Nalcor's 65.8% ownership.

Cash flow from operations for 2012 was $185.9 million, a decrease of $33.3 million from 2011 primarily due to a reduction in cash generated from Oil and Gas and Energy Marketing sales. ROE declined due to a decrease in earnings along with an increase in equity. Nalcor's percentage of equity remained consistent with 2011 due to short-term borrowings which were offset by equity injections from the Province and an increase in equity due to current year earnings.

BUSINESS SEGMENT REVIEW

In 2012, Nalcor reported its financial results in seven business segments: Hydro Regulated; Churchill Falls; Oil and Gas; Energy Marketing; Muskrat Falls Project; Bull Arm Fabrication; and Corporate and Other Activities. These business segments include the six lines of business of Nalcor and are differentiated on the basis of regulatory status and management accountability.

The 2012 net income by business segment is shown in the following table:

millions of dollars	2012	2011
Hydro Regulated	$ 17.1	$ 23.1
Churchill Falls	28.3	24.4
Oil and Gas	32.7	39.1
Energy Marketing	21.2	47.1
Bull Arm Fabrication	4.2	3.7
Corporate and Other Activities	(10.8)	(8.6)
Total	$ 92.7	$ 128.8

HYDRO REGULATED

The operations of Hydro Regulated are influenced by many external factors; including the domestic economy, weather patterns and fuel costs.

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

Net income for 2012 was $17.1 million, a decrease of $6.0 million over the 2011 net income of $23.1 million. The factors affecting the 2012 decreased earnings are depicted in the chart at the bottom of this page.

Hydro Regulated electricity sales include a base energy rate as well as rate adjustments for RSP refunds or recoveries and a fuel rider. Revenue recognized as a result of the RSP mechanisms is deferred as a regulatory adjustment on the income statement. Electricity sales by major customer category are outlined below:

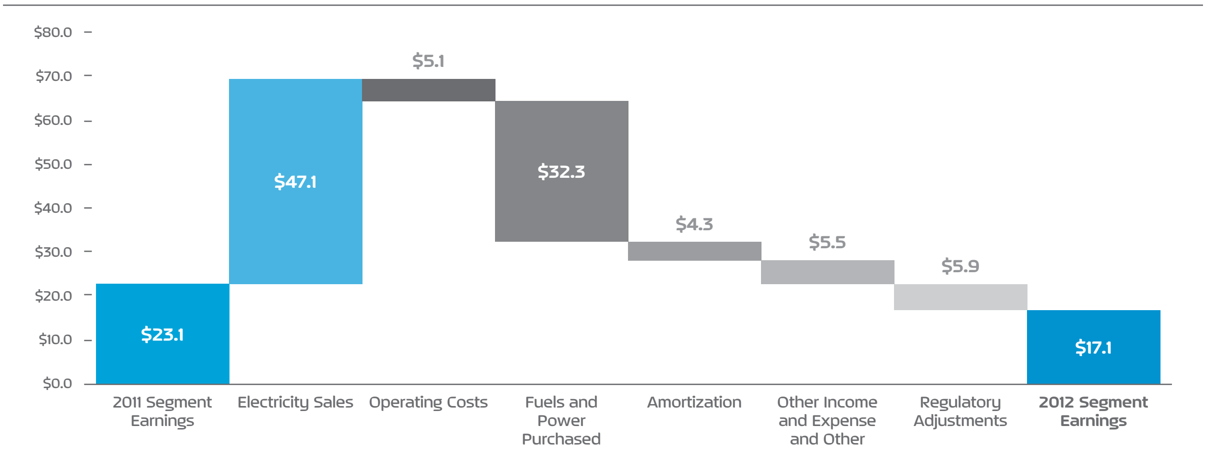
millions of dollars	2012	2011
Newfoundland Power	$ 425.5	$ 384.6
Rural customers	76.9	71.1
Industrial customers/ secondary sales	18.3	17.9
Total Electricity Sales	$ 520.7	$ 473.6

Total revenue from Newfoundland Power increased overall by $40.9 million due to increased sales and an increase in RSP recovery. Electricity sales to Newfoundland Power increased by 42 gigawatt hours (GWh), mainly as a result of increased load growth and colder weather resulting in an increase in revenue of $5.1 million. In addition, there was $35.8 million additional revenue recovered from customers through the operation of the RSP.

Revenue from Hydro Regulated's rural customers increased by $5.8 million due to increased load of 49 GWh and a rate adjustment. The rates for rural customers, other than Labrador Interconnected, are adjusted annually on July 1 as a result of the operation of Newfoundland Power's Rate Stabilization Account.

Sales to industrial customers and secondary sales increased by 65 GWh. This increase in electricity requirement resulted

HYDRO REGULATED - 2012 VS. 2011 SEGMENT EARNINGS | $ MILLIONS



in a $0.4 million increase in revenue after RSP adjustments. On the island, sales increased primarily due to lower electricity generation from customer's own generation sources resulting in higher electricity requirements from Hydro and an increase in load from the oil refining customer. This was partially offset by a decrease in secondary sales in Labrador during this period.

The RSP balance due to customers as at December 31, 2012 was $201.7 million (2011 - $170.3 million). The hydraulic variation that has accumulated in the RSP has been positive in recent years and results from higher than average hydroelectric production, enabled by lower reservoir storage requirement for drought protection due to reduced loads from industrial customers. This higher hydraulic production has reduced some of the requirements for thermal generation and therefore related fuel costs.

The balance in the RSP is also increasing due to reduced loads from industrial customers since 2007 and variations in fuel costs. The increased RSP balance results in higher interest costs, as interest is accrued on the outstanding balance based on the approved weighted average cost of capital of 7.6%. Rates are also adjusted annually based on forecast fuel prices through a fuel rider. The fuel rider and rate adjustment for the accumulated RSP balances becomes effective annually on July 1 for Newfoundland Power. RSP rates for industrial customers are normally set on January 1 of each year.

A portion of the RSP balance totalling approximately $135 million, accumulated since 2007, has been set aside by the PUB to be allocated among the industrial customers and retail customers. This balance is mainly due to reduced use of the Holyrood Thermal Generating Station leading to fuel savings as a result of the shut down of a portion of the pulp and paper industry in the province since 2007.

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

	2012	2011
No. 6 fuel consumption:		
Millions of barrels	1.4	1.5
Average price (CAD/BBL)	$ 114.8	$ 91.9
Diesel fuel consumption:		
Millions of litres	14.8	15.9
Average price (CAD/litre)	$ 1.08	$ 1.03

Fuel costs are summarized below:

millions of dollars	2012	2011
No. 6 fuel and other	$ 166.5	$ 138.9
Diesel	15.9	16.0
Total fuel expense	$ 182.4	$ 154.9

Fuel costs increased by $27.5 million over 2011. Consumption of fuel at the Holyrood Thermal Generating Station decreased by 42,000 barrels which, when combined with fuel price increases, resulted in increased costs for No. 6 fuel over 2011. The RSP is designed to smooth fluctuations in fuel prices and consumption. These RSP adjustments are recorded as regulatory adjustments on the income statement. In 2012, fuel deferrals of $49.3 million were recognized, an increase of $28.4 million from 2011.

To supplement Hydro Regulated's electricity generation on the island, Hydro Regulated purchases power under long-term agreements with non-utility generators (see Note 22(f) to the Consolidated Financial Statements). For 2011 and 2012, Hydro Regulated also entered into a power purchase arrangement with the Government of Newfoundland and Labrador (Government) for the output from the hydroelectric assets on the Exploits River. In Labrador, on the interconnected grid, Hydro Regulated purchases substantially all of its electricity requirements from Churchill Falls. Total power purchased increased by $4.8 million from $52.2 million in 2011 to $57.0 million in 2012. This increase is primarily due to additional power purchased from the Exploits power generation facilities.

Hydro Regulated's 2012 operating costs comprised 53% (2011 - 52%) of consolidated operating costs outlined as follows:

millions of dollars	2012	2011
Salaries	$ 74.1	$ 70.5
Maintenance	19.7	19.0
Other	15.7	14.9
Total	$ 109.5	$ 104.4

Total operating costs increased by $5.1 million over the 2011 level primarily due to an increase in salaries and benefits of $3.6 million mainly due to negotiated union wage settlements and normal cost of living adjustment increases.

Hydro Regulated's amortization expense was $47.5 million, an increase of $4.3 million over 2011, primarily due to increasing levels of property, plant and equipment. Other income and expense increased by $4.8 million due to costs associated with asset disposal costs in 2012.

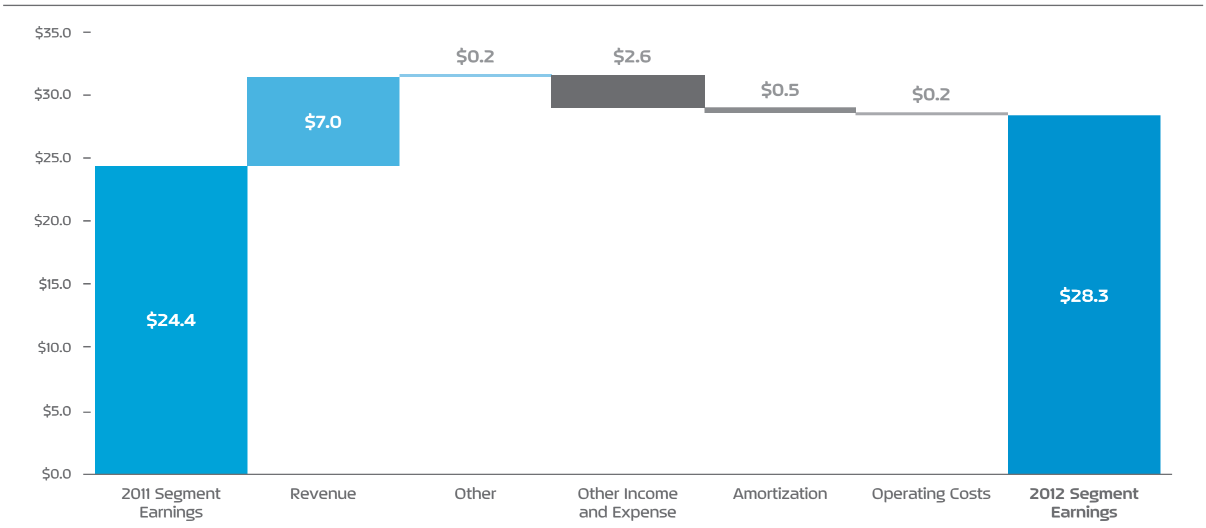
Hydro Regulated invested $77.6 million in capital additions and upgrades in 2012 (2011 - $62.3 million) to ensure continued safe and reliable provision of electricity to the provincial consumers. Investments were made in the following categories:

millions of dollars	2012	2011
Generation	$ 24.4	$ 14.9
Distribution	18.9	22.8
Transmission	27.0	15.1
Other	7.3	9.5
	$ 77.6	$ 62.3

CHURCHILL FALLS

In 2012, Churchill Falls segment earnings were $28.3 million, an increase of $3.9 million compared to 2011. The factors affecting the 2012 increased earnings are depicted in the following chart:

CHURCHILL FALLS - 2012 VS. 2011 SEGMENT EARNINGS | $ MILLIONS



The increase in net income was mainly due to an increase in energy sales to Hydro-Quebec as well as an increase in GWAC revenue as a result of high efficiencies achieved in the fall of 2012. This increase in revenue was partially offset by an increase in depreciation expense and costs associated with the disposal of assets. Churchill Falls experienced lost GWAC revenue in both 2011 and early 2012 due to damage to a generating unit that occurred in the summer of 2011. These losses were covered by business interruption insurance and the unit was returned to service in March 2012.

Churchill Falls' capital requirements are expected to continue to increase as investments are made to replace or repair aging infrastructure at the plant. Churchill Falls has established a long-term asset management plan which addresses capital requirements to keep assets in reliable operating condition to provide reliable service to customers for the long-term. Accordingly, during 2012, Churchill Falls invested $45.7 million net of contributions in aid of construction (2011 - $38.9 million). In accordance with the 1999 Shareholders' Agreement, Churchill Falls maintains a segregated reserve fund to contribute towards funding capital expenditures related to the replacement of existing infrastructure. As at December 31, 2012, this fund had a balance of $77.3 million (2011 - $69.0 million).

On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time. On February 3, 2010, the Government established the Churchill Falls (Labrador) Corporation Trust (Trust) with Churchill Falls as the beneficiary. The purpose of the Trust is to fund the external costs incurred as a result of the motion filed by Churchill Falls and to date, $2.0 million in costs have been incurred in relation to this matter. In 2012, Churchill Falls continued preparations for trial. Court has set a trial date of fall 2013.

OIL AND GAS

Total production in 2012 was 595,000 barrels and total sales were $66.9 million compared to 798,000 barrels and $88.5 million in 2011. The average dated Brent price per barrel realized in 2012 was $116 US dollars (USD) as compared to $113 USD in 2011. Net income for 2012 was $32.7 million, a decrease of $6.4 million from 2011 net income of $39.1 million primarily due to decreased production volumes.

Production volumes were down year over year due to planned maintenance on the Sea Rose Floating Production, Storage and Offloading vessel (FPSO) which underwent a major planned maintenance program from May through August. Production from the White Rose Growth Project was shut down during this maintenance period.

During 2012, costs capitalized as petroleum and natural gas properties totalled $88.3 million (2011 - $63.2 million) and include pre-development, development and drilling costs and project management. The $88.3 million consisted of expenditures related to the White Rose Growth Lands of $15.3 million, Hebron of $48.7 million, Hibernia Southern Extension of $21.4 million and seismic and other exploration expenditures of $2.9 million.

Oil and Gas reserves

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

Reserves as at December 31, 2012:

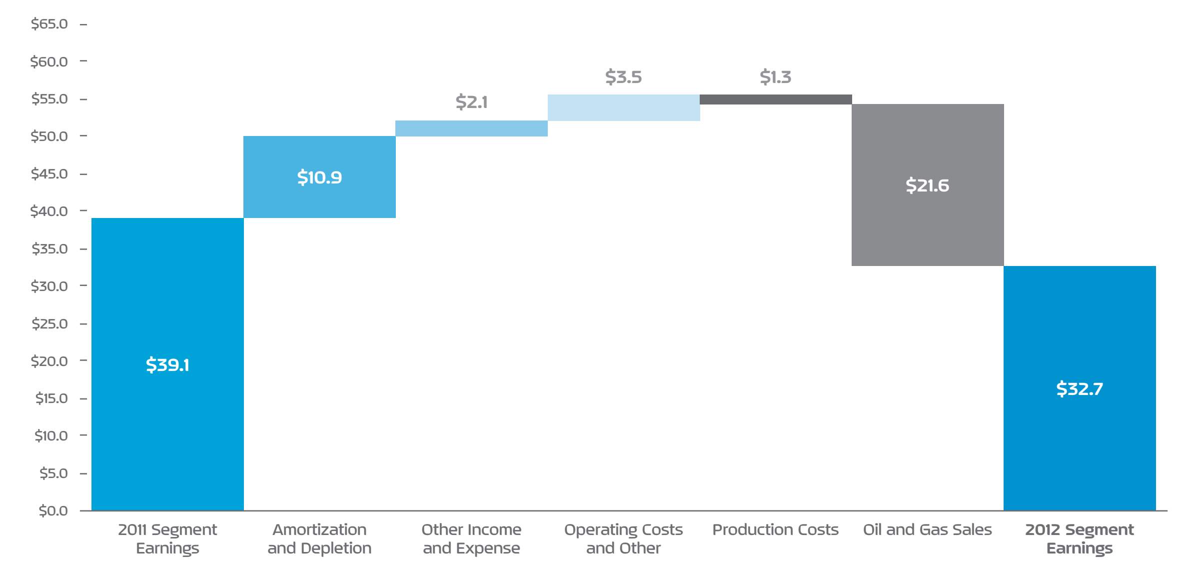
	Light and Medium Oil	
thousands of barrels	Gross	Net
Developed	960	907
Undeveloped	8,118	5,074
Total Proved	9,078	5,981
Probable	47,083	33,814
Total Proved Plus Probable	56,161	39,795

Gross reserves represent Oil and Gas' working interest in remaining reserves, while net reserves represent remaining reserves less royalties. Total Gross Proved and Probable reserves at December 31, 2012 are 56,161 thousands of barrels (mbbls), an increase of 3,461 mbbls over 2011 reserve levels. This increase is mainly a result of field extensions and technical revisions.

Depletion, Depreciation and Amortization (DD&A)

Under the full cost method of accounting for oil and gas activities, DD&A is calculated on a country-by-country

OIL AND GAS - 2012 VS. 2011 SEGMENT EARNINGS | $ MILLIONS



basis. The DD&A rate is calculated by dividing the capital costs subject to DD&A by the proved oil and gas reserves expressed as equivalent barrels (boe). The resultant dollar per boe is assigned to each boe of production to determine the DD&A expense for the period. In 2012, DD&A expense related to oil and gas properties was $18.2 million (2011 - $29.2 million). The decrease is mainly due to a decrease in production levels.

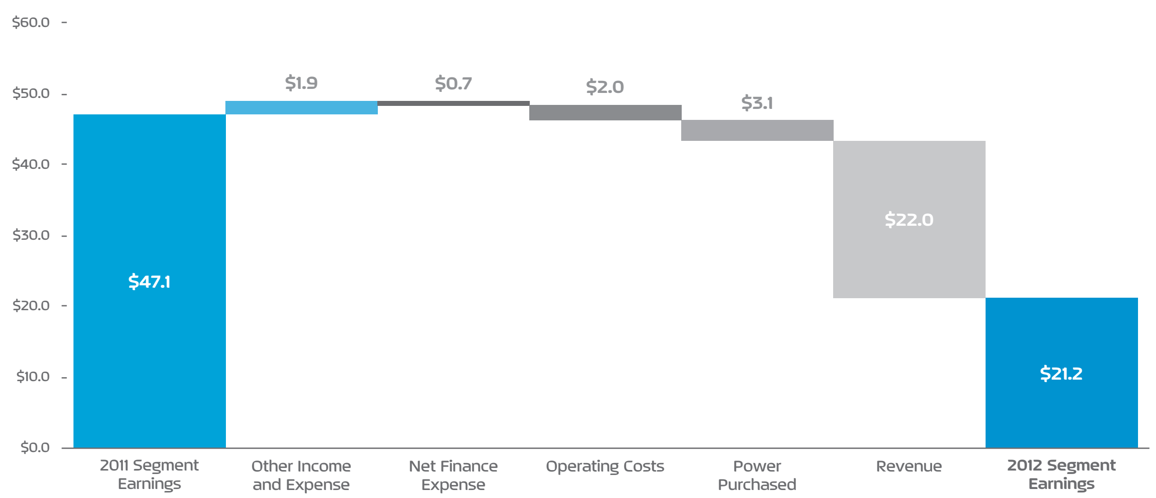
The full cost method of accounting requires the costs of unproved properties and major development projects to be excluded from the DD&A calculation. At December 31, 2012, capital costs related to the Hebron project of $187.1 million (compared with $139.1 million at the end of 2011) were excluded from the DD&A calculation.

ENERGY MARKETING

Segment earnings were $21.2 million, a decrease of $25.9 million from 2011. In 2012, Energy Marketing sales of 1.8 TWh generated $53.6 million in revenue compared to $75.6 million generation from 1.7 TWh in 2011. The primary reason for this decrease was lower export market electricity prices as a result of decreased demand from historically mild winter weather. Details of the year over year change in Energy Marketing earnings are noted in the following chart:

A combination of term contracts, day-ahead and real-time sales provides Nalcor with a diversified sales portfolio. Nalcor's export sales performance is evaluated based on benchmark

ENERGY MARKETING - 2012 VS. 2011 SEGMENT EARNINGS | $ MILLIONS



pricing at an interface in the New York Independent System Operator (NYISO) which corresponds to the delivery point of Nalcor's firm annual transmission booking. In 2012, Nalcor's net revenue from Energy Marketing activities exceeded the NYISO pricing benchmark by 52% (2011 - 18%).

Costs associated with the transmission booking through Quebec increased by $1.0 million due to an increase in regulated transmission rates in Quebec.

Power purchases increased due to increased activity to optimize the Quebec transmission asset which resulted in purchases and resale of electricity in export markets at market prices.

Energy Marketing revenues are denominated primarily in USD. Nalcor uses derivative contracts to mitigate the risk of fluctuations in foreign exchange rates as well as commodity prices. In 2012, Nalcor entered into a series of forward foreign exchange contracts to minimize the impact of fluctuations in electricity prices. Nalcor did not enter into any commodity price swaps in 2012 due to depressed market prices. In 2012, other income and expense includes gains of $0.1 million resulting from derivative contracts, a decrease of $1.9 million from the expenses of $1.8 million in 2011 from hedging activities.

MUSKRAT FALLS PROJECT

In 2012, Nalcor incurred $275.3 million in costs associated with the development of the Muskrat Falls Project (2011 - $89.2 million) resulting in a cumulative investment of $443.3 million. Sanctioned in December 2012, construction is underway and will take approximately five years to complete.

Through its detailed decision gate 3 analyses completed in 2012, Nalcor confirmed the Muskrat Falls Project, with a transmission link between Labrador and the island, to be the lowest-cost alternative to meet the province's growing need for electricity. These analyses were validated through external review.

Leading to project sanction in December, several other important milestones were achieved in 2012. Nalcor received release from the environmental assessment for the Lower Churchill Hydroelectric Generation Project from the governments of Newfoundland and Labrador and Canada in March. Nalcor is incorporating the terms and conditions outlined in the governments' responses into the Muskrat Falls Hydroelectric Generating Project design and planning work.

In April, Nalcor submitted the required Environmental Impact Statement (EIS) for the Labrador-Island Transmission Link environmental assessment. Nalcor's submission of the EIS is an important part of the environmental assessment process for the Labrador-Island Transmission Link. Prior to the submission of the EIS, Nalcor completed significant analysis of the likely environmental effects of the transmission line and Strait of Belle Isle crossing which was incorporated into the EIS prior to submitting it to the provincial and federal governments. Nalcor anticipates a response in 2013.

Nalcor's arrangement with Emera Inc. to construct the Maritime Link will help leverage financial opportunities for export sales of surplus electricity. In July 2012, Nalcor and Emera signed formal agreements for the development and transmission of hydroelectric power from Muskrat Falls. The Maritime Link will provide Nalcor access to the Maritime and New England markets for clean, renewable power that is not required to meet Nalcor's domestic energy needs. Emera's Board of Directors also approved sanction of the Maritime Link in December 2012.

A critical element of the Muskrat Falls Project is the strategic arrangements with industry and government. The completion of the federal loan guarantee in 2012 was an important negotiation with the Government of Canada. The loan guarantee is a significant economic investment in the province and Atlantic Canada, and will result in lower project costs through reduced interest rates. This in turn, will lower electricity prices for consumers.

BULL ARM FABRICATION

During 2012, earnings from the activities at the Bull Arm site were $4.2 million (2011 - $3.7 million). The lease agreement for the site was finalized with ExxonMobil Canada Properties, for the construction and fabrication for the Hebron project, in 2011. 2012 was the first full year of tenancy. Nalcor is focused on utilization of the Bull Arm site during the short

to medium-term for the Hebron project, while planning for a competitive operation with a sustained workforce in the long-term. In addition to obtaining value from the site during the lease period, Nalcor will also align its long-term strategy for Bull Arm to facilitate a seamless transition at the end of the Hebron project. The strategy is intended to position the site to maximize the benefits to the province from construction and fabrication projects in Newfoundland and Labrador and from around the world.

CORPORATE AND OTHER ACTIVITIES

Lower Churchill Project (Phase 2) Gull Island: In 2012 monitoring and assessment of electricity market opportunities in Canada and the US Northeast region was ongoing for Gull Island. In addition, work continued on a legal case for a judicial review that was initiated in 2011 following regulatory decisions made by the Regie de l'energie against Hydro in relation to a dispute with Hydro Quebec regarding a Lower Churchill Project transmission service request. During 2012, court filings were completed in preparation for the Quebec Superior Court hearing that took place in January 2013. The court decision on this case is anticipated later in 2013.

Business Development: Business Development includes activities related to wind development, research and development and other business opportunities. During 2012, the Business Development group continued activity associated with the Wind-Hydrogen-Diesel Energy Project in Ramea. This research and development project uses wind and hydrogen technology to supplement the diesel requirements of this isolated community and has the potential to offset diesel with zero-emission power. The project aims to develop a wind-hydrogen-diesel energy solution designed for small-scale energy production in isolated locations.

In 2012, these activities were not in a commercial stage and as a result produced only minimal revenue. Costs expensed and capitalized in 2012 were $0.5 million (2011 - $0.6 million) and $0.1 million (2011 - $0.7 million), respectively.

Other: Investments in LCDC and GIPCo are included in this category. Both companies are inactive and had minimal transactions in 2012 and 2011.

Corporate costs: Costs associated with the operation of Nalcor, the parent company, are recorded in this category as well as certain non-regulated operating costs. In 2012, operating and other costs were $10.5 million, an increase of $2.5 million over 2011 costs of $8.0 million. The increase is primarily due to increased salaries and benefits expense as well as net finance expense.

FINANCIAL CONDITION REVIEW

ASSETS

Total assets were $3,446.9 million at December 31, 2012, an increase of $405.1 million or 13.3% over December 31, 2011. There were a number of contributing factors to the increase in assets. Nalcor invested $477.4 million in property, plant and equipment and petroleum and natural gas properties. These additions were, in part, offset by amortization and depletion of $79.3 million.

Accounts receivable decreased by $38.6 million primarily due to receipt of funding from the Province related to the UCRA in early 2012. Sinking funds increased by $55.8 million primarily due to investment of funds received related to the UCRA. Other increases include reserve fund investments of $5.5 million and prepaid expenses of $0.8 million. These increases were offset by a decrease in short-term investments of $5.4 million, regulatory assets of $1.4 million, long-term receivables of $0.8 million, inventory of $1.4 million, derivative assets of $0.1 million and a reduction in cash and cash equivalents of $6.6 million.

LIABILITIES

Total liabilities increased by $269.9 million from $1,612.1 million at December 31, 2011, to $1,882.0 million at December 31, 2012. The increase in liabilities was due to an increase in long-term payables of $39.7 million primarily due to the recognition of Nalcor's obligations under the Lower Churchill Impacts and Benefits Agreement (IBA), an increase in trade and other payables of $42.0 million, an increase in short-term borrowing of $125.0 million, an increase in deferred credits primarily related to the Maritime Link of $23.9 million, an increase in decommissioning liabilities of $5.2 million and an increase in employee benefit liability of $7.2 million.

EQUITY

Total Shareholder's equity increased by $135.2 million from $1,429.7 million to $1,564.9 million in 2012. This increase is due primarily to the 2012 earnings of $92.7 million, a decrease in reserves of $2.8 million and an equity contribution from Nalcor's Shareholder (the Province) in the amount of $45.0 million.

LIQUIDITY AND CAPITAL RESOURCES

SOURCES AND USES OF CASH

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

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

millions of dollars	2012	2011
Cash provided by (used in)		
Operating activities	$ 299.8	$ 167.0
Financing activities	231.7	63.2
Investing activities	(538.1)	(256.0)
Net decrease in cash	$ (6.6)	$ (25.8)

Nalcor's primary uses of funds during 2012 were operating expenses and capital spending, including expenditures for the Muskrat Falls Project and oil and gas properties. Cash from operating activities includes net earnings, other non-cash items and working capital. Cash from operating activities of $299.8 million increased from the prior year due to adjustments for non-cash working capital. Cash generated from financing activities of $231.7 million was primarily due to equity injections of $45.3 million and short-term borrowings of $125.0 million. Investing activities included capital expenditures of $389.1 million on plant and equipment; $88.3 million related to oil and gas investments and investments in sinking funds of $64.8 million.

Throughout 2012, Nalcor maintained a demand operating facility with a limit of $100.0 million, with covenants that restricted the issuance of debt such that the unconsolidated debt to total capitalization ratio could not exceed 70%. The covenants further stipulated that the Debt Service Coverage Ratio should at all times be greater than 1.5 to 1.0 on an unconsolidated basis. At December 31, 2012, Nalcor was in compliance with these ratios. At December 31, 2012, there were bankers' acceptances outstanding of $73.0 million and $5.1 million related to four letters of credit. In the first quarter of 2013, Nalcor increased the limit on the operating facility to $150.0 million.

Hydro maintains a short-term promissory note program for funding its ongoing requirements. This program has an authorized limit of $300.0 million and is guaranteed by the 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 access to short-term funds in the Canadian Money Market at attractive rates. At December 31, 2012, there were $52.0 million in short-term notes outstanding. Throughout 2012, Hydro also maintained a $50.0 million unsecured demand operating credit facility and with the exception of letters of credit outstanding of $18.9 million, this bank credit facility was unencumbered at the end of 2012.

Capital markets are the principal source of longer-term funding for Hydro. Hydro's debenture issues are currently assigned an "A" credit rating by DBRS, and are also fully guaranteed by the Province. Hydro's total borrowings outstanding, net of sinking funds, are limited by legislation to $1.6 billion. As of December 31, 2012, total borrowings of $922.8 million were outstanding (2011 - $892.7 million).

The operations of Churchill Falls are financed by cash flow from operations. Unsecured bank credit facilities are also in place in the amount of $10.0 million and with the exception of two letters of credit outstanding of $2.0 million, this bank credit facility was unencumbered at the end of 2012.

The operating and capital requirements of Oil and Gas are financed by funds from operations and injections of equity capital from Nalcor. During 2012, revenue from the sale of crude oil was realized from the White Rose Growth Project and the Hibernia Southern Extension. These revenues were used to offset operating costs and investments in oil and gas assets. Oil and Gas also maintained a $5.0 million demand operating credit facility to meet short-term operating requirements. As at December 31, 2012, Oil and Gas had drawn $3.7 million on the facility. Until such time as Oil and Gas has an earnings and credit profile sufficient to support entry into either the money markets or the capital markets, any financing required to supplement earnings from operations will occur from Nalcor in the form of equity injections. At such time, management will review the funding strategy to ensure continued appropriateness.

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

ACCESS TO WORKING CAPITAL

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

Hydro's short-term debt is rated as R1 (low) by DBRS and A-1 high by Standard and Poors. Both are investment grade credit ratings that facilitate Hydro's access to short-term capital markets. Hydro sells a large portion of its electricity to Newfoundland Power, which is a regulated distribution utility in the province and whose First Mortgage Bonds are rated by DBRS as an "A" credit. Hydro continues to obtain short-term funding through its promissory note program. The notes issued under this program are guaranteed by the Province. At year end, there were $52.0 million in promissory notes outstanding.

Churchill Falls' primary revenue stream is fixed at pricing under a long-term power contract with Hydro-Quebec. Churchill Falls' cash requirements are funded by cash from operations with periodic working capital needs met through ready access to cash and high quality short-term investments. At year end, Churchill Falls had access to $13.9 million in cash and highly-liquid short-term investments. It also had access to a reserve fund totalling $77.3 million for use in meeting unanticipated capital expenditures.

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

CAPITAL STRUCTURE

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

millions of dollars	2012	2011
Current portion long-term debt	$ 8.2	$ 8.2
Long-term debt (net of sinking funds)	862.6	884.5
Short-term borrowing	125.0	-
Total debt	$ 995.8	$ 892.7
Shareholder's equity	$1,564.9	$ 1,429.7
Total debt to capital [1]	38.9%	38.4%
Fixed rate debt as percentage of total indebtedness [2]	87.0%	100.0%
EBIT to interest coverage [3]	2.1	2.5
FFO to debt [4]	15.7%	20.7%

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

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

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

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

Nalcor's capital structure is key to its ability to execute its long-term strategy. Nalcor has significantly improved its financial strength over the past several years which has positioned Nalcor to facilitate growth and re-investment. This financial strength results in access to lower-cost debt and has allowed Nalcor to pursue strategic partnering opportunities. This also enables growth activities, such as the Lower Churchill Project, Oil and Gas investments and large capital investments in Hydro Regulated and Churchill Falls as part of Nalcor's long-term asset management plan.

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

Nalcor measures its capital structure using the key measures of debt to capital, earnings before interest and tax (EBIT) to interest coverage, funds from operations (FFO) to debt, weighted average term to maturity and the fixed to floating rate debt ratio to monitor its capital structure. Both the weighted average term to maturity and the fixed to floating debt ratio are periodically compared to utility industry benchmarks and if deemed appropriate, adjustments to the capital structure are made. Over the past few years, Nalcor realized a significant improvement in the debt to capital ratio as a result of strong earnings and contributed capital received from the Province. This equity funding, combined with a policy to reinvest all earnings, resulted in a significant reduction in debt in Nalcor's capital structure. EBIT to interest coverage decreased year over year due to decreased earnings with relatively stable interest costs. During 2012, Nalcor's FFO to debt decreased due to a decrease in operating cash flows before working capital adjustments.

The proportion of fixed rate debt as a percentage of total indebtedness decreased to 87% at the end of 2012 from 100% at the end of 2011 due to short-term promissory notes issued.

OBLIGATIONS AND COMMITMENTS

Obligations and commitments for the five-year period 2013 to 2017 are as follows:

millions of dollars	2013	2014	2015	2016	2017
Debt repayments (1)	$ -	$ 125.0	$ -	$ 225.0	$ 150.0
Sinking fund installments	8.2	8.2	8.2	8.2	6.7
Power purchase agreements (2)	24.9	24.5	24.7	24.9	25.2
Transmission capacity (3)	18.9	4.7	-	-	-
Total	$ 52.0	$ 162.4	$ 32.9	$ 258.1	$ 181.9

(1) *Includes repayment of long-term debt. Sinking funds have been established for all debts issues, excluding the 2016 maturity.*

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

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

RELATED PARTY TRANSACTIONS

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

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

Intercompany transactions and balances have been eliminated upon consolidation.

The related party transactions included in the financial statements are described in Note 23 of the Consolidated Financial Statements.

SECTION 3: RISK MANAGEMENT PROCESS

Nalcor is committed to identifying and managing risk in a manner that supports disciplined corporate planning and strategy formulation. Integration between risk management and strategic planning has become increasingly important as the business grows and Nalcor's risk profile continues to evolve. Nalcor focuses on an execution of risk management and mitigation strategies in each line of business utilizing a common risk framework and toolset.

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

The Board approved an Enterprise Risk Management (ERM) plan for Nalcor which included endorsement of a framework that is consistent with Risk Management Guidelines and Principles per ISO/CSA 31000. The ERM Framework provides for a timely, systematic and structured approach to identifying, evaluating, controlling, reporting and monitoring risks that have the potential to impact on the achievement of Nalcor's goals. Management is responsible for the ongoing monitoring and review of the Corporation's risk profile and for ensuring that the ERM framework is fully operationalized according to the five-year ERM plan.

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

Risks are identified at the business unit level and rated according to severity and likelihood of occurrence. Mitigation strategies include initiatives such as insurance contracts, hedging transactions, asset management and capital improvements.

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

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

STRATEGIC RISK

Strategic risk management is a critical part of Nalcor's ERM process, focused on the most consequential and significant risks to enterprise value. Nalcor has identified key strategic risks within each line of business that could impede the achievement of strategic objectives and has employed mitigation strategies integrated with Nalcor's strategy planning and execution to provide reasonable assurance such events will not prevent the achievement of corporate goals and objectives.

OPERATIONAL RISK

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

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

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

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

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

SAFETY

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

INFORMATION TECHNOLOGY

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

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

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

ENVIRONMENTAL

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

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

REGULATORY

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

FUTURE GROWTH ACTIVITIES

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

FINANCIAL RISK

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

CREDIT RISK

Nalcor is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. Procedures and practices designed to manage the credit risks

associated with the various business activities throughout Nalcor include assessment and monitoring of counterparty creditworthiness, setting of credit limits and various forms of credit assurance. The majority of receivables are from regulated utilities and investment grade counterparties, which minimizes credit risk.

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

Nalcor is also exposed to potential cost overages and delays with respect to its major supply and install and construction contracts in the event that a contractor experiences financial difficulty. For the Muskrat Falls Project, this risk is addressed by the contracting strategy, which incorporates a formal procedure for verifying the creditworthiness of entities bidding on Muskrat Falls' contracts. These procedures assess the bidder's financial stability and capacity to perform and evaluate the contractor's ability to absorb risk, as well as the level of risk the contractor is able to absorb without diminishing its ability to perform under the contract. Identification of the exposure and ability to absorb the risk is important in assessing the exposure to Nalcor and Nalcor's ability to backstop the risk. For successful contractors, who have been awarded work on the Muskrat Falls Project, an annual review of the financial statements and credit worthiness will ensure that the financial status remains within an acceptable limit.

LIQUIDITY RISK

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Short-term liquidity is provided by cash and cash equivalents, funds from operations and maintenance of borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations. Cash flows are monitored continuously. Long-term liquidity is provided through the issuance of debentures in the capital markets and injections of equity capital in support of large project investments. The funding obligations associated with the longer-term debentures are managed through a balanced approach to debt maturity and a program of sinking fund investment. Debt maturities are managed to avoid overly demanding funding requirements in any given year.

MARKET RISK

Interest Rates: Nalcor has a $150.0 million demand operating facility. Hydro's short-term funding is managed under a

Provincially-guaranteed promissory note program having a $300.0 million limit and a $50.0 million demand operating facility with its banker. Churchill Falls and Oil and Gas both maintain demand operating facilities in the amount of $10.0 million and $5.0 million, respectively.

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

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

Hydro Regulated's exposure on the purchase of No. 6 fuel is mitigated through the operation of the RSP. Hydro Regulated employs the periodic use of forward contracts as a means by which future exposure to exchange rate fluctuations on any given day can be avoided. As at December 31, 2012, there were no forward contracts outstanding in connection with No. 6 fuel purchases. During 2012, total electricity sales denominated in USD were $33.8 million (2011 - $67.9 million). In 2012, Hydro mitigated foreign exchange risk on a portion of these sales through the use of foreign currency forward contracts. In March of 2012, Hydro entered into a series of ten monthly foreign exchange forward contracts with a notional value of $39.1 million USD to hedge foreign exchange risk on 75% of Hydro's planned budgeted USD electricity sales for the year. These contracts had an average exchange rate of $1.00 CAD per USD. During 2012, $0.1 million in gains from these contracts were included in other income and expense (2011 - $1.9 million loss). In 2012, management elected not to implement hedges aimed at addressing electricity price risk due to depressed market pricing conditions.

During 2012, total oil sales denominated in USD were $69.2 million (2011 - $90.4 million). While Oil and Gas had exposure to fluctuations in the USD/CAD exchange rate on those sales, a significant portion of Oil and Gas' planned capital expenditures for 2012 were denominated in USD, which mitigated this exposure. In 2012, Oil and Gas entered into a series of three commodity price swaps with a notional value of $2.8 million USD to mitigate price exposure on 10% of remaining budgeted production for the year. During 2012, $0.2 million in gains from these contracts were included in other income and expense (2011 - $2.0 million loss).

During 2012, total rental revenues from Bull Arm denominated in USD were $4.9 million (2011 - $3.9 million). During 2012, Bull Arm entered into a series of nine monthly foreign exchange forward contracts with a notional value of $3.6 million USD to hedge foreign exchange risk on 100% of the remaining budgeted rental revenue. These contracts had an average exchange rate of $1.00 CAD per USD.

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

COMPLIANCE RISK

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

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

SECTION 4: CRITICAL ACCOUNTING ESTIMATES

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

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

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

EMPLOYEE FUTURE BENEFITS

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

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

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

CRITICAL ACCOUNTING 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 13 to the Consolidated Financial Statements.

ASSET RETIREMENT OBLIGATIONS

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

IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT

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

FULL COST ACCOUNTING FOR PETROLEUM AND NATURAL GAS PROPERTIES

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

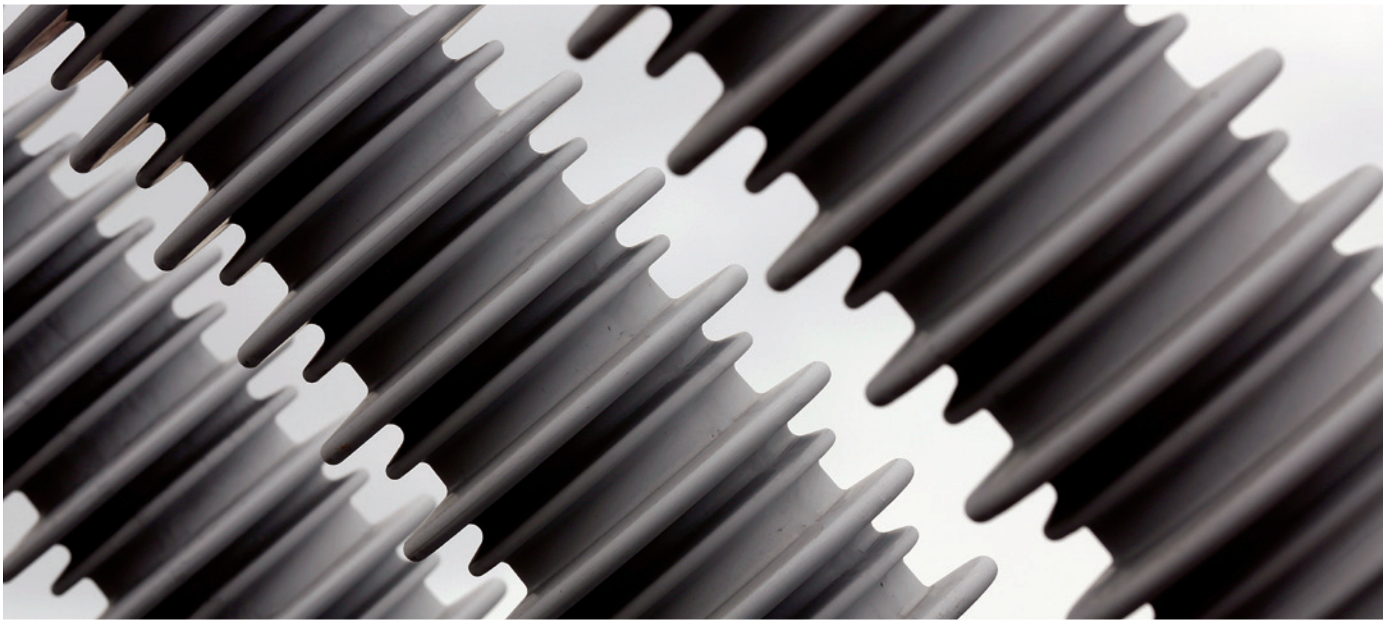
REGULATION

Generally, the accounting policies applicable to Hydro are subject to examination and approval by the PUB. These accounting policies may differ from those used by entities not subject to rate regulation. The timing of the recognition of certain assets, liabilities, revenues and expenses may differ from that otherwise expected using Canadian GAAP for entities not subject to rate regulation. Regulatory assets and regulatory liabilities arise as a result of the rate-setting process and have been recorded based on previous, existing or expected future regulatory orders. Certain estimates are necessary until these amounts are finalized pursuant to regulatory decisions or other regulatory proceedings. The final amounts approved by the PUB for deferral as regulatory assets and regulatory liabilities and the approved recovery or settlement periods may differ from those originally expected. Any resulting adjustments to original estimates are reported in earnings in the period in which they become known. As at December 31, 2012, Hydro Regulated had $65.0 million in current and long-term regulatory assets (2011 - $66.4 million) and $202.2 million in current and long-term regulatory liabilities (2011 - $170.9 million). The nature of Hydro Regulated's regulatory assets and liabilities is described in Note 6 to the Consolidated Financial Statements.

USEFUL LIFE OF CAPITAL ASSETS

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

Amortization is an estimate based primarily on the anticipated useful life of assets that reflects current facts and historical information. Nalcor's consolidated property, plant and equipment represents approximately 71% of total consolidated assets as at December 31, 2012 (2011 - 69%). Amortization expense associated with property, plant and equipment was $61.1 million during 2012 (2011 - $56.0 million). Due to the size of Nalcor's property,



plant and equipment, changes in amortization rates can have a significant impact on amortization expense.

During 2012, Hydro changed its amortization methodology from sinking fund to straight-line and also applied new service lives. This change resulted in a restatement of 2011 amortization expense. See Note 3 to the Consolidated Financial Statements.

CONTINGENCIES

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

SECTION 5: FUTURE ACCOUNTING CHANGES

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

The Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2015. Nalcor is a qualifying entity and chose to use the deferral option for the year ended December 31, 2012. Nalcor will continue to assess the timing of its transition to IFRS.

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

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

ACCOUNTING POLICY DECISIONS AND IMPACTS

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

Regulatory Assets and Liabilities

Nalcor currently uses certain accounting policies specific to rate-regulated activities under Canadian GAAP which permit the recognition of regulatory assets and liabilities. The concept of rate regulatory accounting does not exist under current IFRS. The inability to recognize regulatory assets and liabilities after implementing IFRS may have a significant impact on Nalcor's earnings due to a change in the timing of recognition of revenues and expenses. The International Accounting Standards Board (IASB) is currently working on developing an interim standard to allow the recognition of regulatory assets and liabilities until a full project on regulatory accounting can be completed.

Property, Plant and Equipment

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

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

Investment in Subsidiaries

Nalcor owns 65.8% of Churchill Falls through its 100% owned subsidiary, Hydro. Due to the 1999 shareholders agreement between Hydro and Hydro-Quebec, the nature of the relationship is that of joint venturers. Since the activities are classified as those of a joint venture, Nalcor intends to account for its investment in Churchill Falls as an equity investment and will no longer proportionately consolidate its share of the results and activities of this entity.

Petroleum and Natural Gas Properties

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

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

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

During 2013, Nalcor will continue to review all proposed and continuing projects of the IASB, closely monitor any initiatives of the International Financial Reporting Interpretations Committee with potential to impact financial reporting and will participate in related initiatives as appropriate.

Management Report

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

The Consolidated Financial Statements have been prepared by management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to April 23, 2013. Financial information presented elsewhere in the Business and Financial Report is consistent with that in the Consolidated Financial Statements.

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

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

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

Ed Martin
President and Chief Executive Officer

Derrick Sturge
Vice President, Finance and Chief Financial Officer

Independent Auditor's Report

To the Lieutenant-Governor in Council

Province of Newfoundland and Labrador

We have audited the accompanying consolidated financial statements of Nalcor Energy, which comprise the consolidated balance sheet as at December 31, 2012, and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

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

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

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

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Nalcor Energy as at December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
St. John's, NL
Canada
April 23, 2013

Consolidated Balance Sheet

As at December 31 (millions of dollars)	Notes	2012	2011
ASSETS			
Current assets			
Cash and cash equivalents		12.1	18.7
Short-term investments		11.5	16.9
Accounts receivable		125.0	163.6
Current portion of regulatory assets	6	2.2	2.8
Inventory		62.1	63.5
Prepaid expenses		5.6	4.8
Derivative assets		0.1	0.2
		218.6	270.5
Property, plant and equipment	4	2,435.0	2,109.5
Petroleum and natural gas properties	5	376.0	304.2
Regulatory assets	6	62.8	63.6
Other long-term assets	7	354.5	294.0
		3,446.9	3,041.8
LIABILITIES			
Current liabilities			
Short-term borrowings	10	125.0	-
Accounts payable and accrued liabilities		198.1	156.1
Current portion of long-term debt	10	8.2	8.2
Current portion of regulatory liabilities	6	169.0	137.6
Current portion of deferred credits	9	7.2	11.3
Current portion of asset retirement obligations	11	1.4	-
Derivative liabilities		-	0.2
		508.9	313.4
Long-term debt	10	1,125.9	1,131.5
Regulatory liabilities	6	33.2	33.3
Asset retirement obligations	11	30.0	24.8
Deferred credits	9	28.0	-
Long-term payables	12	82.4	42.7
Employee future benefits	13	73.6	66.4
		1,882.0	1,612.1
SHAREHOLDER'S EQUITY			
Share capital	14	122.5	122.5
Contributed capital	14	435.8	390.5
		558.3	513.0
Accumulated other comprehensive income	14	43.6	46.4
Retained earnings		963.0	870.3
		1,006.6	916.7
		1,564.9	1,429.7
		3,446.9	3,041.8

Commitments and contingencies (Note 22)

Subsequent events (Note 24)

See accompanying notes

On Behalf of the Board

Ed Martin
Director

Gerald Shortall
Director

Consolidated Statement of Income & Retained Earnings

For the year ended December 31 (millions of dollars)	Notes	2012	2011
Revenue			
Energy sales	15	**710.4**	700.0
Other revenue	15	**15.7**	14.1
		726.1	714.1
Expenses			
Fuels		**182.4**	154.9
Power purchased		**60.8**	52.9
Operating costs	16	**206.9**	200.1
Net finance expense	19	**73.6**	70.9
Amortization and depletion		**79.3**	85.2
Other income and expense		**0.4**	(2.8)
Regulatory adjustments	6	**30.0**	24.1
		633.4	585.3
Net income		**92.7**	128.8
Retained earnings at beginning of year		**870.3**	741.5
Retained earnings at end of year		**963.0**	870.3

See accompanying notes

Consolidated Statement of Comprehensive Income

For the year ended December 31 (millions of dollars)	Notes	2012	2011
Net income		**92.7**	128.8
Other comprehensive (loss) income	14	**(2.8)**	19.1
Comprehensive income		**89.9**	147.9

See accompanying notes

Consolidated Statement of Cash Flows

For the year ended December 31 (millions of dollars)	Notes	2012	2011
Cash provided by (used in)			
Operating activities			
Net income		**92.7**	128.8
Adjusted for items not involving a cash flow			
Amortization and depletion		**79.3**	85.2
Accretion		**2.7**	0.5
Increase in employee future benefits		**7.2**	6.0
Loss (gain) on disposal of property, plant and equipment		**3.6**	(1.9)
Other		**0.4**	0.6
		185.9	219.2
Changes in non-cash working capital balances	20	**113.9**	(52.2)
		299.8	167.0
Financing activities			
Increase in contributed capital		**45.3**	16.4
Increase in deferred credits		**23.9**	8.7
Short-term borrowings		**125.0**	-
Increase in long-term payables		**37.5**	38.1
		231.7	63.2
Investing activities			
Additions to property, plant and equipment		**(389.1)**	(190.7)
Additions to petroleum and natural gas properties		**(88.3)**	(63.2)
Increase in other long-term assets		**(69.6)**	(5.7)
Decrease (increase) in short-term investments		**5.4**	(1.2)
Proceeds on disposition of property, plant and equipment		**3.5**	4.8
		(538.1)	(256.0)
Net decrease in cash		**(6.6)**	(25.8)
Cash position at beginning of year		**18.7**	44.5
Cash position at end of year		**12.1**	18.7
Cash position is represented by			
Cash		**12.1**	18.7
Cash equivalents		**-**	-
		12.1	18.7

Supplementary cash flow information (Note 20)

See accompanying notes

Notes to Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS

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

1.1 SUBSIDIARIES

Nalcor holds interests in the following subsidiaries:

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

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

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

In 2012, Nalcor created new subsidiaries as part of advancing the Muskrat Falls Project. The new subsidiaries are associated with the development, construction, financing and operation the Labrador-Island Link and include the Labrador-Island Link General Partner Corporation(LIL GP) and the Labrador-Island Link Holding Corporation (LIL Holdco). Nalcor also created the Labrador-Island Link Partnership (LIL Partnership) in accordance with the Labrador-Island Link Limited Partnership Agreement to develop the Labrador-Island link. LIL Holdco holds 100% of the Class A Units.

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

1.2 JOINTLY CONTROLLED ENTITIES

Nalcor holds interests in the following jointly controlled entities:

Churchill Falls (Labrador) Corporation Limited (Churchill Falls) is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW). Nalcor owns 65.8% of Churchill Falls.

Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974. Churchill Falls owns 33.33% of Twin Falls.

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

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 BASIS OF PRESENTATION

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

2.2 PRINCIPLES OF CONSOLIDATION

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

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

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

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

2.3 USE OF ESTIMATES

Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization and depletion, property, plant and equipment, the valuation of oil and gas reserves and related depletion and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

2.4 RATES AND REGULATIONS

Hydro's revenues from its electrical sales to most customers within the province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2011 - 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the Consolidated Financial Statements are disclosed in Note 6.

2.5 CASH AND CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash and cash equivalents and short-term investments consist primarily of Canadian Treasury Bills and Banker's Acceptances (BAs). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. The short-term investments bear interest rates of 1.26% to 1.35% (2011 - 0.74% to 1.24%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

2.6 INVENTORY

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

2.7 PROPERTY, PLANT AND EQUIPMENT

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

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

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

Nalcor, Oil and Gas and Bull Arm Fabrication

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

Hydro

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

Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Generation Plant	
Hydroelectric	45 to 100 years
Thermal	35 to 65 years
Diesel	25 to 55 years
Transmission	
Lines	30 to 65 years
Terminal stations	40 to 55 years
Distribution system	30 to 55 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dikes, 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, dikes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching station 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

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment which are carried at costless accumulated amortization. Amortization is calculated on a straight-line basis over estimated useful lives ranging from 5 to 55 years. Amortization methods, useful lives and residual values are reviewed at each reporting date.

Churchill Falls

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

Hydroelectric generation plant	45 to 100 years
Transmission and terminals	30 to 65 years
Service facilities and other	7 to 45 years

2.8 CAPITALIZED INTEREST

Interest is charged to construction in progress until the project is complete at rates equivalent to the weighted average cost of debt. Capitalized interest cannot exceed actual interest incurred.

2.9 IMPAIRMENT OF LONG-LIVED ASSETS

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

2.10 PETROLEUM AND NATURAL GAS PROPERTIES

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

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

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

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

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

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

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

2.11 ASSET RETIREMENT OBLIGATIONS

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

2.12 EMPLOYEE FUTURE BENEFITS

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

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

2.13 REVENUE RECOGNITION

Electricity Sales

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

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

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

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, is tracked over a four-year period and then either recovered from or refunded to Hydro-Quebec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2011 - 7%).

Oil Sales

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

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

Lease Revenue

Lease revenue is recognized when services have been rendered; recovery of the consideration is probable; and the amount of revenue can be reliably estimated.

2.14 FOREIGN CURRENCY TRANSLATION

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

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

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

2.15 FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Financial Instruments

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

Nalcor has classified its financial instruments as follows:

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

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

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

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Nalcor to manage market risk. Nalcor's policy is not to utilize derivative instruments for speculative purposes. Nalcor may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Nalcor formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges. Nalcor had no derivatives designated as hedges at December 31, 2012 (2011 - nil).

2.16 FUTURE ACCOUNTING CHANGES – INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

The Canadian Accounting Standards Board (AcSB) amended the introduction to Part 1 of the Canadian Institute of Chartered Accounts (CICA) Handbook – Accounting to allow qualifying entities with rate-regulated activities to defer the adoption of IFRS to January 1, 2015. Nalcor is a qualifying entity and chose to use the deferral option for the year ended December 31, 2012.

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

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

3. CHANGE IN ACCOUNTING POLICIES

During 2012, Hydro adopted new accounting policies as approved by the PUB in Order No P.U. 13(2012). These policy changes were applied retroactive to January 1, 2011. The policy changes are as follows:

Capitalization of property, plant and equipment

Previously, Hydro capitalized certain general overhead costs and training costs and included the costs of asset overhauls and major inspections as an operating expense. Hydro's revised policy is to expense general overheads and training costs as incurred and to capitalize costs associated with asset overhauls and major inspections. These changes resulted in a decrease in net income of $1.3 million for the year ended December 31, 2011.

Employee future benefits

Previously, Hydro accounted for employee future benefits under the corridor method whereby the excess of gains and losses over 10% of the accrued benefit obligation is amortized to income over the expected average remaining service life of the employee group.

Hydro's revised policy is to defer the amortization of actuarial gains and losses recognized in employee future benefits expense through regulatory adjustments. This change resulted in an increase in net income of $1.2 million for the year ended December 31, 2011.

Amortization of property, plant and equipment

Previously, Hydro amortized hydroelectric generating assets and transmission assets using the sinking fund method. Hydro's new policy is to calculate amortization using the straight-line methodology. As part of the methodology change, Hydro also changed its estimate of service lives effective January 1, 2011. In the absence of regulatory approval, this change would have been applied retroactively resulting in a decrease in retained earnings as at January 1, 2011 of $210.7 million. Pursuant to Order No. P.U. 13 (2012), the PUB approved the use of the carrying value of property, plant and equipment under Canadian GAAP as deemed cost at January 1, 2011. As the deemed cost of Hydro's regulated property, plant and equipment is recoverable through future rates, no adjustment to opening retained earnings is necessary. These changes resulted in an increase in net income of $2.2 million for the year ended December 31, 2011.

4. PROPERTY, PLANT AND EQUIPMENT

	Cost	Contributions In Aid of Construction	Accumulated Amortization	Net Book Value
(millions of dollars)		**2012**		
Electric – generation	**1,501.0**	**2.4**	**371.7**	**1,126.9**
Electric – transmission and distribution	**672.8**	**18.5**	**92.9**	**561.4**
Development projects	**618.0**	**-**	**-**	**618.0**
Other	**202.5**	**23.1**	**50.7**	**128.7**
	2,994.3	**44.0**	**515.3**	**2,435.0**

	Cost	Contributions In Aid of Construction	Accumulated Amortization	Net Book Value
(millions of dollars)		2011		
Electric – generation	1,468.7	2.4	341.2	1,125.1
Electric – transmission and distribution	615.3	7.6	76.0	531.7
Development projects	337.5	-	-	337.5
Other	173.6	15.5	42.9	115.2
	2,595.1	25.5	460.1	2,109.5

As at December 31, 2012 the cost of assets under construction and therefore excluded from costs subject to amortization was $661.2 million (2011 - $384.3 million).

Included in Development projects is $609.3 million related to the Lower Churchill Project (2011 - $329 million). Phase 1 of the Project, which was sanctioned in December 2012, will result in the development of the 824 MW Muskrat Falls site, with power being transmitted over a new transmission line (the Labrador-Island Transmission Link) to be constructed from Labrador across the Strait of Belle Isle to the Avalon Peninsula on the island of Newfoundland, and the development of a new transmission system (the Maritime Transmission Link) from Newfoundland to Nova Scotia, for the provision of power to Emera in Nova Scotia and the provision of market access to Nalcor. Nalcor will also obtain transmission access in Nova Scotia, New Brunswick and Maine from Emera. Nalcor will own and finance 100% of Muskrat Falls and the Labrador Transmission Assets. Nalcor and Emera, through a partnership in which Nalcor has the majority interest, will finance the Labrador-Island Transmission Link. The Maritime Transmission Link will be 100% owned and financed by Emera.

5. PETROLEUM AND NATURAL GAS PROPERTIES

(millions of dollars)	2012	2011
Petroleum and natural gas properties	**434.0**	344.0
Less: accumulated depletion	**58.0**	39.8
	376.0	304.2

Internal costs directly related to acquisition, exploration and development activities capitalized in 2012 were $0.1 million (2011 - $0.5 million).

As at December 31, 2012, $187.1 million (2011 - $139.1 million) of accumulated costs of petroleum and natural gas properties were not subject to depletion and depreciation.

Oil and Gas properties include Nalcor's acquisition costs and proportionate share of exploration and development costs. Nalcor has a 4.9% working interest in the Hebron oil field, a 5.0% working interest in the White Rose Growth Project, and a 10% working interest in the Hibernia Southern Extension. Nalcor also has an average working interest of 99% in two onshore exploration permits in Parson's Pond on the Great Northern Peninsula. A third exploration permit, in which Nalcor had a 62% interest, has expired.

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

6. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	2012	2011	Remaining Recovery Settlement Period (years)
Regulatory assets			
Foreign exchange losses	**62.6**	64.7	29.0
Deferred major extraordinary repairs	**-**	0.6	-
Deferred energy conservation costs	**2.4**	1.1	n/a
Total regulatory assets	**65.0**	66.4	
Less current portion	**2.2**	2.8	
	62.8	63.6	
Regulatory liabilities			
Rate stabilization plan (RSP)	**201.7**	170.3	n/a
Deferred purchased power savings	**0.5**	0.6	14.5
Total regulatory liabilities	**202.2**	170.9	
Less current portion	**169.0**	137.6	
	33.2	33.3	

6.1 REGULATORY ADJUSTMENTS RECORDED IN THE CONSOLIDATED STATEMENT OF INCOME

(millions of dollars)	2012	2011
RSP recovery	60.4	25.4
Rural rate adjustment	7.0	4.4
RSP fuel deferral	(49.3)	(20.9)
RSP interest	13.2	12.2
Amortization of deferred foreign exchange losses	2.1	2.1
Deferred foreign exchange (losses) gains on fuel	(0.4)	0.2
Employee future benefit actuarial losses	(2.3)	(1.2)
Amortization of major extraordinary repairs	0.6	1.7
Deferred energy conservation	(1.4)	(0.5)
Insurance proceeds	0.2	0.8
Deferred purchased power savings	(0.1)	(0.1)
	30.0	24.1

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

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

6.2 RATE STABILIZATION PLAN

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25% of the outstanding balance at year end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect. A portion of the RSP balance totaling approximately $135.0 million (2011 - $102.0 million) has been set aside by the PUB and will be subject to a future regulatory ruling on the allocation between the industrial customers and retail customers. This balance is mainly due to fuel savings at the Holyrood Thermal Generating Station (HTGS) as a result of the shutdown of a portion of the pulp and paper industry in the Province since 2007.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2012, $49.3 million was deferred (2011 - $20.9 million) in the RSP and $60.4 million (2011 - $25.4 million) was recovered through rates and included in energy sales.

Hydro's rural rates on the Island Interconnected and Isolated systems are primarily based upon retail rates. Therefore, when a rate adjustment for retail rates has been approved by the PUB, Hydro's rural customers receive the same rate change. In 2012, the rural rate adjustment reduced income and increased the RSP liability by $7.0 million (2011 - $4.4 million). In the absence of rate regulation, the rate adjustment would have been recorded in income.

Hydro is required to charge or pay interest on balances accumulating in the RSP at a rate equal to Hydro's weighted average cost of capital. As a result, Hydro recognized interest expense of $13.2 million in 2012 (2011 - $12.2 million).

6.3 DEFERRED FOREIGN EXCHANGE LOSSES

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty year period. This amortization, of $2.1 million annually, is included in regulatory adjustments.

6.4 DEFERRED MAJOR EXTRAORDINARY REPAIRS

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the HTGS. This program was carried out over a three year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2012, $0.6 million (2011 - $1.7 million) of amortization was recognized in operating costs.

6.5 DEFERRED ENERGY CONSERVATION COSTS

Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2012, $1.4 million (2011 - $0.5 million) was deferred.

6.6 DEFERRED PURCHASED POWER SAVINGS

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30-year period. The remaining unamortized savings of $0.5 million (2011 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

6.7 PROPERTY, PLANT AND EQUIPMENT

Pursuant to Order No P.U. 13 (2012), the PUB approved the use of the carrying amount of property, plant and equipment under Canadian GAAP as the deemed cost at January 1, 2011.

During 2010, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2009. Based on the results of this study and PUB approval, amortization previously calculated using the 'sinking fund' method under Canadian GAAP is now calculated on a straight-line basis. In addition, the service lives for certain assets have also been revised.

The PUB permits major inspections to be included in the cost of capital and amortized over the average expected period of the next major inspection. In 2012, $6.8 million (2011 - $0.9 million) was recognized as property, plant and equipment. In the absence of rate regulation, Canadian GAAP would require that Hydro include the major inspections as operating costs in the year incurred.

6.8 FOREIGN EXCHANGE GAINS AND LOSSES

Hydro purchases a significant amount of fuel in US dollars. The RSP allows Hydro to defer variances in fuel prices (including foreign exchange fluctuations). During 2012, Hydro deferred foreign exchange losses on fuel purchases of $0.4 million (2011 - $0.2 million gain). In the absence of rate regulation, Canadian GAAP would require that Hydro include gains and losses on foreign currencies in net finance expenses in the period incurred.

6.9 INSURANCE PROCEEDS

Pursuant to Order No. P.U. 13 (2012), Hydro records net insurance proceeds in excess of $50,000 against the capital costs of the related assets. In 2012, Hydro recorded net insurance proceeds of $0.2 million (2011- $0.8 million) against costs of the related assets.

6.10 EMPLOYEE FUTURE BENEFITS

Pursuant to Order No. P.U. 13 (2012), Hydro defers the amortization of actuarial gains and losses. During 2012, Hydro deferred actuarial gains and losses of $2.3 million (2011 - $1.2 million).

7. OTHER LONG-TERM ASSETS

(millions of dollars)		2012	2011
Long-term receivables	(a)	**0.8**	1.6
Sinking funds	(b)	**302.8**	247.0
Reserve fund	(c)	**50.9**	45.4
		354.5	294.0

Notes to Consolidated Financial Statements

(a) The balance of $0.8 million (2011 - $1.6 million) includes the non-current portion of receivables associated with customer time payment plans and the long-term portion of employee purchase programs of $0.2 million (2011 - $0.2 million). During 2012, refundable deposits associated with applications for transmission service into Nova Scotia and New Brunswick were settled (2011 - $1.4 million). During 2011, Hydro-Quebec refunded two deposits totaling $24.1 million associated with applications for transmission service through Quebec. The remaining balance of $0.6 million (2011 - nil) relates to differences between the Annual Energy Base (AEB) in the Power Contract and energy delivered accumulating over the four-year period from September 2012 to August 2016.

(b) As at December 31, 2012, sinking funds include $263.3 million (2011 - $247.0) related to repayment of Hydro's long-term debt and $39.5 million (2011 - nil) related to funding of Nalcor's long-term payable under the UCRA.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada, provincial governments or Schedule 1 banks, and have maturity dates ranging from 2013 to 2041.

Hydro debentures, which are intended to be held to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are in accordance with bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 1.38% to 9.86% (2011 - 3.12% to 9.86%).

Nalcor sinking funds are held to fund the annual payments to the Innu Nation as required under the Upper Churchill Redress Agreement (UCRA).

(millions of dollars)	2012	2011
Sinking funds at beginning of year	**247.0**	208.2
Contributions	**48.1**	8.2
Earnings	**12.6**	11.0
Redemptions	**(2.0)**	-
Valuation adjustment	**(2.9)**	19.6
Sinking funds at end of year	**302.8**	247.0

Sinking fund instalments due for the next five years are as follows:

(millions of dollars)	2013	2014	2015	2016	2017
Sinking fund instalments	8.2	8.2	8.2	8.2	6.7

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

(millions of dollars)	2012	2011
Opening balance	**45.4**	39.3
Contribution	**5.3**	5.3
Net interest	**0.3**	0.1
Mark-to-market adjustment	**(0.1)**	0.7
Fair value of reserve fund	**50.9**	45.4

8. JOINT VENTURE

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

(millions of dollars)	2012	2011
Current assets	39.9	41.8
Long-term assets	383.2	394.8
Current liabilities	20.5	19.0
Long-term liabilities	15.6	16.2
Revenues	73.5	64.2
Expenses	48.6	43.1
Net income	24.9	21.1
Cash provided by (used in)		
Operating activities	33.1	32.3
Financing activities	(2.5)	0.9
Investing activities	(23.8)	(32.6)

Income tax expense in the amount of $0.1 million (2011 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been included in expenses.

9. DEFERRED CREDITS

Deferred credits consist of funding from the Government of Newfoundland and Labrador, deferred revenue from Emera Inc., deferred lease revenue and oil production.

Hydro has received funding from the Province for wind feasibility studies in Labrador. Oil and Gas has received funding from the Province for oil and gas exploration initiatives. Funding related to studies and programs are amortized to income directly against the related expenditures as the costs are incured.

In July 2012, Nalcor entered into agreements with Emera Inc. related to the Muskrat Falls project. Under these agreements, Emera is constructing the Maritime Link in exchange for the provision of power by Nalcor for a 35-year period. Nalcor has recorded deferred revenue of $28.0 million which equals the construction costs to date incurred by Emera. Nalcor controls the Maritime Link asset and as such has recorded the costs as a component of property, plant and equipment under construction.

Other includes deferred lease revenue and over-lift on oil production. The following is a schedule of the deferred credits for the year:

(millions of dollars)	Hydro Wind Credits	Oil and Gas Program Funding	Deferred Energy Sales	Other	Total
Balance at January 1, 2011	-	2.2	-	0.3	2.5
Additions	3.5	8.0	-	0.6	12.1
Amortization	-	(3.3)	-	-	(3.3)
Balance at December 31, 2011	3.5	6.9	-	0.9	11.3
Additions	-	2.3	28.0	0.5	30.8
Amortization	(1.6)	(4.4)	-	(0.9)	(6.9)
Balance at December 31, 2012	1.9	4.8	28.0	0.5	35.2
Less: current portion	1.9	4.8	-	0.5	7.2
	-	-	28.0	-	28.0

10. DEBT

10.1 SHORT-TERM BORROWINGS

Nalcor maintains a $100.0 million unsecured demand operating credit facility with its banker. Borrowings in Canadian dollars may take the form of Prime Rate Advances, BAs and Letters of Credit. Borrowings in USD may take the form of Base Rate Advances, LIBOR Advances and Letters of Credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate. At year end, the drawings on the facility were four irrevocable letters of credit. One was issued to the Department of Fisheries and Oceans (DFO), two were issued to the Newfoundland Labrador Offshore Petroleum Board, and one was issued to Newfoundland Transshipment. The letter of credit issued to DFO in the amount of $0.3 million was in connection with the operation of hydroelectric assets on the Exploits River. The remaining letters of credit totaled $4.8 million and relate to Oil and Gas to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

Hydro maintains a $50.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2011 - nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year end, Hydro had 24 letters of credit outstanding, reducing the availability of the credit facility by $18.9 million (2011 - $18.9 million).

Churchill Falls maintains a $10.0 million Canadian or US equivalent unsecured demand operating credit facility with its banker and at year end there were no amounts drawn on the facility (2011 - nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. Churchill Falls has issued three irrevocable letters of credit, totaling $2.0 million, to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes granted by the Department of Environment and Conservation.

Oil and Gas maintains a $5.0 million unsecured credit facility. As at December 31, 2012, $3.7 million was drawn on the facility (2011 - nil).

Short-term borrowings consist of promissory notes in Hydro totalling $52.0 million and bankers' acceptances in Nalcor totalling $73.0 million. There were no short-term borrowings at December 31, 2011.

10.2 LONG-TERM DEBT

Details of long-term debt are as follows:

(millions of dollars)	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	**2012**	2011
V *	125.0	10.50	1989	2014	**124.8**	124.7
X *	150.0	10.25	1992	2017	**149.4**	149.4
Y *	300.0	8.40	1996	2026	**293.8**	293.5
AB *	300.0	6.65	2001	2031	**306.3**	306.5
AD *	125.0	5.70	2003	2033	**123.7**	123.6
AE	225.0	4.30	2006	2016	**224.2**	224.0
Total debentures	1,225.0				**1,222.2**	1,221.7
Less: sinking fund investments in own debentures					**88.1**	82.0
					1,134.1	1,139.7
Less: payments due within one year					**8.2**	8.2
					1,125.9	1,131.5

* Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 25 basis points annually on the total debt (net of sinking funds) with a remaining term to maturity less than ten years and 50 basis points annually on total debt (net of sinking funds) with a remaining term to maturity greater than ten years. The fee for 2012 was $3.7 million (2011 - $3.9 million).

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

(millions of dollars)	2013	2014	2015	2016	2017
Long-term debt repayment	-	125.0	-	225.0	150.0

11. ASSET RETIREMENT OBLIGATIONS

Nalcor has recognized liabilities associated with the retirement of portions of the HTGS, disposal of polychlorinated biphenyls (PCB) and retirement obligations associated with Nalcor's net interest in petroleum and natural gas properties. The reconciliation of the beginning and ending carrying amount of asset retirement obligations is as follows:

(millions of dollars)	**2012**	2011
Obligations at beginning of year	**24.8**	14.8
Liabilities incurred	**1.4**	3.7
Accretion	**1.0**	0.7
Revisions	**4.3**	5.6
Settlements	**(0.1)**	-
Obligations at end of year	**31.4**	24.8
Less current portion:	**1.4**	-
	30.0	24.8

The total undiscounted estimated cash flows required to settle the HTGS obligations at December 31, 2012 are $32.1 million (2011 - $27.0 million). Payments to settle the liability are expected to occur between 2020 and 2024. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at a credit adjusted risk free rate of 2.8% (2011 - 2.9%).

The total undiscounted estimated cash flows required to settle the PCB obligations at December 31, 2012 are $3.6 million (2011 - $3.6 million). Payments to settle the liability are expected to occur between 2013 and 2025. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at credit adjusted risk free rates ranging between 3.1% and 5.5% (2011 - 3.1% and 5.6%).

Oil and Gas asset retirement obligations result from net ownership interests in petroleum and natural gas properties and related well sites. The total undiscounted estimated cash flows required to settle the obligations at December 31, 2012 is $10.7 million (2011 - $8.9 million). Payments to settle the liability are expected to occur between 2020 and 2030. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at credit adjusted risk free rates ranging between 4.7% and 6.3% (2011 - 5.0% to 6.2%).

A significant number of Nalcor's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Nalcor's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Nalcor is legally required to remove, an asset retirement obligation for those assets will be recognized at that time.

12. LONG-TERM PAYABLES

(millions of dollars)	2012	2011
Balance at beginning of year	**45.1**	4.6
Additions and revisions	**43.2**	40.5
Accretion	**2.2**	-
Balance at end of year	**90.5**	45.1
Less: current portion	**(8.1)**	(2.4)
	82.4	42.7

The long-term payables consist of a payable to the Innu Nation under the UCRA, a payable to the Innu Nation under the Impact and Benefits Agreement (IBA), a payable to Hydro-Quebec related to the AEB and a penalty payment regarding the Hebron Oil and Gas project.

Under the UCRA, Nalcor is required to pay to the Innu Nation, \$2.0 million annually escalated by 2.5% annually until 2041. Currently, \$2.1 million (2011 - \$2.0 million) of the amount is current and is recorded in trade and other payables. Nalcor has sinking funds in the amount of \$40.0 million to fund these future obligations.

Under the IBA, Nalcor is required to make annual payments to the Innu Nation commencing on sanction of the Muskrat Falls Project. The Muskrat Falls Project was sanctioned in December 2012 and the first IBA payment was made at that time. The IBA requires annual payments of \$5.0 million escalated by the annual consumer price index from sanction until first commercial power. The present value of the payments using a discount rate of 3.7% is \$40.4 million (2011 - nil). The current portion of the payable at December 31, 2012 is \$5.0 million.

In September 2012, the joint venture partners in the Hebron project executed the Benefits Agreement Drilling Equipment Set (DES) Settlement Agreement. This Agreement allowed the Hebron partners to adjust the Hebron Benefits Agreement such that the Hebron Project DES could be constructed at a geographic location outside of Newfoundland and Labrador in exchange for a one-time payment to the Province. The total payment was agreed to be \$150.0 million payable on June 30, 2016. Nalcor's proportionate 4.9% share of the payment will be \$7.3 million. Oil and Gas has recognized the present value of its payable of \$6.4 million determined using a discount rate of 3.4%.

The long-term payable to Hydro-Quebec as at December 31, 2012 is the accumulation of differences between energy delivered and the AEB energy base billed during the four-year period from September 1, 2008 to August 31, 2012. Monthly repayments commenced in September 2012 and will terminate on August 31, 2016. The current portion of \$1.0 million (2011 - \$0.4 million) is included in Accounts payable and accrued liabilities. The long-term portion is \$2.6 million (2011 - \$4.8 million).

13. EMPLOYEE FUTURE BENEFITS

13.1 PENSION PLAN

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of \$6.8 million (2011 - \$6.4 million) are expensed as incurred.

13.2 OTHER BENEFITS

Nalcor provides group life insurance and health care benefits on a cost shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2012, cash payments to beneficiaries for its unfunded other employee future benefits was \$3.0 million (2011 - \$2.6 million). An actuarial valuation was performed at December 31, 2012.

Notes to Consolidated Financial Statements

(millions of dollars)	2012	2011
Accrued benefit obligation		
Balance at beginning of year	113.1	87.5
Current service cost	4.6	3.3
Interest cost	5.0	5.1
Actuarial (gain) loss	(1.0)	21.0
Regulatory adjustments	(2.3)	(1.2)
Benefits paid	(3.0)	(2.6)
Balance at end of year	116.4	113.1
Plan deficit	116.4	113.1
Unamortized actuarial loss	(42.6)	(46.5)
Unamortized past-service cost	(0.2)	(0.2)
Accrued benefit liability at end of year	73.6	66.4

(millions of dollars)	2012	2011
Component of benefit cost		
Current service cost	4.6	3.3
Interest cost	5.0	5.1
Actuarial (gain) loss	(1.0)	21.0
	8.6	29.4
Difference between actuarial gain or loss and amount recognized	3.9	(19.6)
Benefit expense	12.5	9.8

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

	2012	2011
Discount rate – benefit cost	4.55%	5.75%
Discount rate – accrued benefit obligation	4.00%	4.55%
Rate of compensation increase	3.50%	3.50%

Assumed healthcare trend rates:

	2012	2011
Initial health care expense trend rate	6.00%	7.50%
Cost trend decline to	4.50%	5.00%
Year that rate reaches the rate it is assumed to remain at	2020	2016

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

Increase	2012	2011
Current service and interest cost	2.3	1.7
Accrued benefit obligation	23.1	23.1

Decrease	2012	2011
Current service and interest cost	(1.7)	(1.3)
Accrued benefit obligation	(17.5)	(17.6)

14. SHAREHOLDER'S EQUITY

14.1 SHARE CAPITAL

(millions of dollars)	2012	2011
Common shares of par value $1 each		
Authorized: unlimited		
Issued and outstanding 122,500,000	122.5	122.5

14.2 CONTRIBUTED CAPITAL

(millions of dollars)	2012	2011
Total contributed capital	435.8	390.5

On February 3, 2010, the Province established the Churchill Falls (Labrador) Corporation Trust (the Trust) with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the Power Contract. During 2012, the Province contributed capital in the amount of $45.0 million (2011 - $16.0 million) and the Trust contributed $0.3 million (2011 - $0.4 million).

14.3 ACCUMULATED OTHER COMPREHENSIVE INCOME

(millions of dollars)	2012	2011
Balance at beginning of year	46.4	27.3
Other comprehensive (loss) income	(2.8)	19.1
Balance at end of year	43.6	46.4

15. REVENUE

(millions of dollars)	2012	2011
Electricity sales	627.5	598.5
GWAC revenue	16.0	13.0
Oil sales	68.7	90.1
Royalties	(1.8)	(1.6)
Total energy sales	710.4	700.0
Lease revenue	5.2	4.3
Government funding	4.4	3.7
Preferred dividends	3.4	3.3
Other	2.7	2.8
Total other revenue	15.7	14.1

16. OPERATING COSTS

(millions of dollars)	2012	2011
Salaries and benefits	**114.8**	107.7
Maintenance and materials	**36.8**	37.5
Transmission rental	**19.7**	18.7
Professional services	**15.7**	12.9
Oil and gas production costs	**10.4**	9.0
Other operating costs	**9.5**	14.3
Total	**206.9**	200.1

17. CAPITAL MANAGEMENT

Nalcor's principal business requires ongoing access to capital in order to maintain assets to ensure the continued delivery of safe and reliable service to its customers. Therefore, Nalcor's primary objective when managing capital is to ensure ready access to capital at a reasonable cost, to minimize its cost of capital within the confines of established risk parameters, and to safeguard Nalcor's ability to continue as a going concern.

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

A summary of the capital structure is outlined below:

(millions of dollars)	2012		2011	
Debt				
Long-term debt	**1,125.9**		1,131.5	
Short-term borrowings	**125.0**		-	
Current portion of long-term debt	**8.2**		8.2	
Sinking funds	**(263.3)**		(247.0)	
	995.8	**38.9%**	892.7	38.4%
Equity				
Share capital	**122.5**		122.5	
Contributed capital	**435.8**		390.5	
Accumulated other comprehensive income	**43.6**		46.4	
Retained earnings	**963.0**		870.3	
	1,564.9	**61.1%**	1,429.7	61.6%
Total debt and equity	**2,560.7**	**100.0%**	2,322.4	100.0%

Nalcor's unsecured demand operating facility has covenants restricting the issuance of debt such that the unconsolidated debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the debt service coverage ratio should at all times be greater than 1.5 to 1.0 on an unconsolidated basis. As at December 31, 2012, Nalcor was in compliance with these covenants.

17.1 HYDRO

Hydro's unsecured demand operating facility has covenants restricting the issuance of debt such that the debt to total capitalization ratio cannot exceed 70%. The covenants further stipulate that the debt service coverage ratio should at all times be greater than 1.5 to 1.0. As at December 31, 2012, Hydro was in compliance with these covenants.

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

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

Legislation stipulates that the total of the short-term loans issued by Hydro and outstanding at any time shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300.0 million. There was $52.0 million outstanding as at December 31, 2012 (2011 - nil). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

17.2 OIL AND GAS

Oil and Gas' objective when managing capital is to maintain the ability to fund operating costs and expenditures related to development and production assets, on a timely basis. Oil and Gas maintains an unsecured demand credit facility, which is used to finance operations in the short-term. Long-term capital includes share capital, contributed capital and retained earnings. Oil and Gas' future requirements for capital are expected to increase, as construction begins on new development assets. During this time, it is expected that Oil and Gas' cash from operations will be sufficient to fund a portion of its capital needs. Additional requirements will be funded entirely through contributed capital.

17.3 BULL ARM FABRICATION

Bull Arm Fabrication's objective when managing capital is to maintain its ability to continue as a going concern. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Commencing in January 2009, earnings are retained by Bull Arm Fabrication and reported in retained earnings. Prior to this, net earnings received were payable to the Province.

17.4 CHURCHILL FALLS

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

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

18. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

18.1 FAIR VALUE

The estimated fair values of financial instruments as at December 31, 2012 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Nalcor might receive or incur in actual market transactions.

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

Establishing Fair Value

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

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

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

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

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

	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
(millions of dollars)		**December 31, 2012**		December 31, 2011	
Financial assets					
Cash and cash equivalents	1	**12.1**	**12.1**	18.7	18.7
Short-term investments	1	**11.5**	**11.5**	16.9	16.9
Accounts receivable	1	**125.0**	**125.0**	163.6	163.6
Derivative assets	2	**0.1**	**0.1**	0.2	0.2
Sinking funds – investments in same Hydro issue	2	**88.1**	**107.3**	82.0	103.7
Sinking funds – other investments	2	**302.8**	**302.8**	247.0	247.0
Reserve fund	2	**50.9**	**50.9**	45.4	45.4
Long-term receivable	2	**0.8**	**0.8**	1.6	1.6
Financial liabilities					
Accounts payable and accrued liabilities	1	**198.1**	**198.1**	156.1	156.1
Short-term borrowings	1	**125.0**	**125.0**	-	-
Derivative liabilities	2	**-**	**-**	0.2	0.2
Long-term debt including amount due within one year (before sinking funds)	2	**1,222.2**	**1,668.6**	1,221.7	1,695.3
Long-term payables	2	**82.4**	**82.6**	42.7	43.2

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

There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2012 and 2011.

18.2 RISK MANAGEMENT

Nalcor is exposed to certain credit, liquidity and market price risks through its operating and financing activities. Financial risk is managed in accordance with a board approved policy, which outlines the objectives and strategies for the management of financial risk, including the use of derivative contracts. Permitted financial risk management strategies are aimed at minimizing the volatility of Nalcor's expected future cash flows.

Credit Risk

Nalcor's expected future cash flows are exposed to credit risk through its operating activities, primarily due to the potential for non-performance by its customers, and through its financing and investing activities, based on the risk of non-performance by counterparties to its financial instruments. The degree of exposure to credit risk on cash and cash equivalents, short-term investments, long-term investments and derivative assets as well as from the sale of electricity to customers, including the associated accounts receivable, is determined by the financial capacity and stability of those customers and counterparties. The maximum exposure to credit risk on these financial instruments is represented by their carrying values on the balance sheet at the reporting date.

Credit risk on cash and cash equivalents is considered to be minimal, as Nalcor's cash deposits are held by a Canadian Schedule 1 Chartered Bank with a rating of A+ (Standard and Poor's).

Credit risk on short-term investments is minimized by limiting holdings to high-quality, investment grade securities issued by the Governments of Canada or any of the provinces, as well as Bankers' Acceptances and term deposits issued by Canadian Schedule 1 Chartered Banks.

Credit exposure on Nalcor's sinking funds is limited by restricting the holdings to long-term debt instruments issued by the Government of Canada or any province of Canada, crown corporations and Canadian Schedule 1 Chartered Banks. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the remainder of the long-term investment portfolio:

	Issuer Credit Rating	Fair Value of Portfolio %	Issuer Credit Rating	Fair Value of Portfolio %
(millions of dollars)		2012		2011
Provincial Governments	AA- to AAA	4.71%	AA- to AAA	4.19%
Provincial Governments	A- to A+	52.75%	A- to A+	57.75%
Provincially owned utilities	A- to A+	37.31%	A- to A+	32.43%
Schedule 1 Canadian banks	A- to A+	1.64%	A- to A+	1.31%
Provincially owned utilities	BBB+	3.59%	BBB+	4.32%
		100.00%		100.00%

Credit exposure on the reserve fund is mitigated by adhering to an investment policy which restricts the holdings to long-term debt instruments issued or guaranteed by the Government of Canada or any province of Canada. Investment in the long-term debt instruments of Canadian banks are also permitted, provided the bank is rated A or higher by Standard and Poor's. With the exception of Government of Canada, holdings of any one issuer are limited to 10% of the total principal amount of the portfolio. The following credit risk table provides information on credit exposures according to issuer type and credit rating for the reserve fund:

	Issuer Credit Rating	Fair Value of Portfolio %	Issuer Credit Rating	Fair Value of Portfolio %
(millions of dollars)	2012		2011	
Provincial Governments	AA- to AAA	13.19%	AA- to AAA	17.03%
Canadian Schedule 1 banks	AA- to AAA	12.70%	AA- to AAA	17.94%
Provincial Governments	A- to A+	20.86%	A- to A+	23.12%
Provincially owned utilities	A- to A+	13.39%	A- to A+	14.65%
Canadian Schedule 1 banks	A- to A+	39.86%	A- to A+	27.26%
		100.00%		100.00%

Credit exposure on derivative assets is limited by the Financial Risk Management Policy, which restricts available counterparties for hedge transactions to Canadian Schedule 1 Chartered Banks and Federally Chartered US Banks.

Nalcor's exposure to credit risk on its energy sales and associated accounts receivable is determined by the credit quality of its customers. Nalcor's three largest customers are not covered by the credit policies outlined in the Financial Risk Management Policy. These customers account for 83.8% (2011 - 72.3%) of total energy sales and 57.9% (2011 - 63.4%) of accounts receivable. These customers are comprised of rate regulated entities and/or organizations with investment grade credit ratings.

Nalcor does not have any significant amounts that are past due and uncollectable, for which a provision has not been recognized at December 31, 2012.

Liquidity Risk

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities, including any derivative liabilities related to hedging activities. Liquidity risk management is aimed at ensuring cash is available to meet those obligations as they become due.

Short-term liquidity for Nalcor and its subsidiaries is mainly provided through cash and cash equivalents on hand, funds from operations and a $100.0 million (2011 - $100.0 million) demand operating credit facility which Nalcor maintains with its banker. In addition Hydro has access to a $300.0 million promissory note program and a $50.0 million (2011 - $50.0 million) unsecured demand operating credit facility. Oil and Gas and Churchill Falls also maintain small demand operating facilities of $5.0 million (2011 - $5.0 million) and $10.0 million (2011 - $10.0 million) respectively. Churchill Falls also maintains a $10.0 million minimum cash balance.

Long-term liquidity risk for Nalcor is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2013 to 2033. Sinking funds have been established for these issues, with the exception of the issue maturing in 2016. For Churchill Falls, long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the June 1999 shareholders' agreement and a dividend management policy that meets long-term liquidity requirements associated with Churchill Falls' capital expenditure program.

The following are contractual maturities of Nalcor's financial liabilities, including principal and interest as at December 31, 2012:

(millions of dollars)	<1 Year	1-3 Years	3-5 Years	>5 Years	Total
Accounts payable and accrued liabilities	198.1	-	-	-	198.1
Short-term borrowings	125.0	-	-	-	125.0
Long-term debt	-	125.0	375.0	725.0	1,225.0
Interest	61.8	160.6	135.7	588.7	946.8
Long-term payables	15.3	156.1	406.7	796.1	1,374.2
	400.2	441.7	917.4	2,109.8	3,869.1

Market Risk

In the course of carrying out its operating, financing and investing activities, Nalcor is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities. Market price movements to which Nalcor has significant exposure include those relating to prevailing interest rates, foreign exchange rates, most notably USD/CAD, and current commodity prices, most notably the spot prices for diesel fuel, electricity, No. 6 fuel and oil. These exposures were addressed as part of the 2012 Financial Risk Management Strategy.

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities classified as held for trading or available for sale, which includes Nalcor's cash and cash equivalents, short-term investments, sinking funds and reserve fund. Expected future cash flows associated with those financial instruments can also be impacted. The impact of a 0.5% change in interest rates on net income and other comprehensive income associated with cash and cash equivalents, short-term investments and debt and short-term debt would have been negligible throughout 2012 due to the short time period to maturity.

The table below shows the impact of a 50 basis point change in interest rates on net income and other comprehensive income associated with the sinking funds and reserve fund at the balance sheet date:

	Net Income		Other Comprehensive Income	
(millions of dollars)	0.5% decrease	0.5% increase	0.5% decrease	0.5% increase
Sinking fund	(0.1)	0.1	11.0	(10.3)
Interest on reserve fund	-	-	1.1	(0.7)
	(0.1)	0.1	12.1	(11.0)

The impact of interest rates on the expected future cash outflows related to short-term debt, which includes promissory notes and banker's acceptances issued under Nalcor's credit lines and long-term debt, are managed within the corporate financing strategy, and whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Nalcor attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Foreign Currency and Commodity Exposure

Nalcor's primary exposure to both foreign exchange and commodity price risk arises from its purchases of No. 6 fuel for consumption at the HTGS, USD denominated electricity sales, rental revenues and the sale of crude oil. These exposures are addressed in accordance with the board-approved Financial Risk Management Policy. Tactics used to address these exposures include the use of forward rate agreements and fixed price commodity swaps.

During 2012, total electricity sales denominated in USD were $33.8 million (2011 - $67.9 million). In 2012, Hydro mitigated foreign exchange risk on a portion of these sales through the use of foreign currency forward contracts. In March 2012, Hydro entered into a series of ten monthly foreign exchange forward contracts with a notional value of $39.1 million USD to hedge foreign exchange risk on 75% of Hydro's planned USD electricity sales for the year. These contracts had an average exchange rate of $1.00 CAD per USD. In 2012, management elected not to implement commodity price hedges aimed at addressing electricity price risk due to depressed market pricing conditions. During 2012, $0.1 million in gains from these derivative contracts were included in other income and expense (2011 - $1.9 million loss).

During 2012, total oil sales denominated in USD were $69.2 million (2011 - $90.4 million). While Oil and Gas had exposure to fluctuations in the USD/CAD exchange rate on those sales, a significant portion of Oil and Gas' planned capital expenditures for 2012 were denominated in USD, which mitigated this exposure. In 2012 Oil and Gas entered into a series of three commodity price swaps with a notional value of $2.8 million USD to mitigate price exposure on 10% of remaining budgeted production for the year. During 2012, $0.2 million in gains from these contracts were included in other income and expense (2011 - $2.0 million).

During 2012, total rental revenues at Bull Arm denominated in USD were $4.9 million (2011 - $3.9 million). In March 2012, Bull Arm entered into a series of nine monthly foreign exchange forward contracts with a notional value of $3.6 million USD to hedge foreign exchange risk on rental revenue. These contracts had an average exchange rate of $1.00 CAD per USD.

19. NET FINANCE EXPENSE

(millions of dollars)	2012	2011
Finance income		
Interest on sinking fund	18.8	16.6
Interest on reserve fund	1.6	1.5
Other interest income	1.6	5.0
	22.0	23.1
Finance expense		
Long-term debt	90.5	90.5
Accretion	2.7	0.5
Debt guarantee fee	3.7	3.9
Other	1.4	0.7
	98.3	95.6
Interest capitalized during construction	(2.7)	(1.6)
	95.6	94.0
Net finance expense	73.6	70.9

20. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	2012	2011
Accounts receivable	38.6	(70.0)
Inventory	1.4	(0.5)
Prepaid expenses	(0.8)	(0.1)
Regulatory assets	1.4	3.3
Regulatory liabilities	31.3	11.1
Accounts payable and accrued liabilities	42.0	4.0
Changes in non-cash working capital balances	113.9	(52.2)
Income taxes paid	0.1	0.2
Interest received	3.3	2.5
Interest paid	92.0	90.9

21. SEGMENT INFORMATION

Nalcor operates in seven business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Quebec. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. Bull Arm Fabrication consists of an industrial fabrication site which is leased for major construction of development projects. Energy Marketing includes the sale of electricity to markets outside the province and other non-regulated electricity sales. Muskrat Falls includes the development of a new hydroelectricity facility and related infrastructure in the province. Corporate and other activities encompass development activities including Phase 2 of the lower Churchill hydroelectric development and corporate activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those described in Note 2.

(millions of dollars)	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Corporate and Other Activities	Muskrat Falls	Bull Arm	Inter-Segment	Total
					2012				
Revenue									
Energy sales	520.7	73.0	66.9	53.6	0.2	-	-	(4.0)	710.4
Other revenue	2.1	0.5	4.5	-	-	-	5.2	3.4	15.7
	522.8	73.5	71.4	53.6	0.2	-	5.2	(0.6)	726.1
Expenses									
Fuels	182.4	-	-	-	-	-	-	-	182.4
Power purchased	57.0	0.1	-	7.7	-	-	-	(4.0)	60.8
Operations and administration	109.5	42.0	20.4	24.7	9.3	-	1.0	-	206.9
Net finance expense	74.0	(1.6)	(0.3)	0.1	1.4	-	-	-	73.6
Amortization	47.5	12.7	18.7	-	0.3	-	0.1	-	79.3
Other income and expense	5.3	(4.6)	(0.1)	(0.1)	-	-	(0.1)	-	0.4
Regulatory adjustments	30.0	-	-	-	-	-	-	-	30.0
	505.7	48.6	38.7	32.4	11.0	-	1.0	(4.0)	633.4
Net income (loss) from operations	17.1	24.9	32.7	21.2	(10.8)	-	4.2	3.4	92.7
Preferred dividends	-	3.4	-	-	-	-	-	(3.4)	-
Net income (loss)	17.1	28.3	32.7	21.2	(10.8)	-	4.2	-	92.7
Capital expenditures	77.6	30.1	88.8	-	5.6	275.3	-	-	477.4
Total assets	1,906.4	456.2	392.7	3.5	252.5	443.3	13.6	(21.3)	3,446.9

Notes to Consolidated Financial Statements

	Hydro Regulated	Churchill Falls	Oil and Gas	Energy Marketing	Corporate and Other Activities	Muskrat Falls	Bull Arm	Inter-Segment	Total
(millions of dollars)					2011				
Revenue									
Energy sales	473.6	66.2	88.5	75.6	-	-	-	(3.9)	700.0
Other revenue	2.3	0.3	3.5	-	-	-	4.7	3.3	14.1
	475.9	66.5	92.0	75.6	-	-	4.7	(0.6)	714.1
Expenses									
Fuels	154.9	-	-	-	-	-	-	-	154.9
Power purchased	52.2	-	-	4.6	-	-	-	(3.9)	52.9
Operations and administration	104.4	41.8	21.4	22.7	8.8	-	1.0	-	200.1
Net finance expense	73.5	(1.4)	(0.1)	(0.6)	(0.5)	-	-	-	70.9
Amortization	43.2	12.2	29.6	-	0.2	-	-	-	85.2
Other income and expense	0.5	(7.2)	2.0	1.8	0.1	-	-	-	(2.8)
Regulatory adjustments	24.1	-	-	-	-	-	-	-	24.1
	452.8	45.4	52.9	28.5	8.6	-	1.0	(3.9)	585.3
Net income (loss) from operations	23.1	21.1	39.1	47.1	(8.6)	-	3.7	3.3	128.8
Preferred dividends	-	3.3	-	-	-	-	-	(3.3)	-
Net income (loss)	23.1	24.4	39.1	47.1	(8.6)	-	3.7	-	128.8
Capital expenditures	62.3	25.6	63.3	-	13.5	89.2	-	-	253.9
Total assets	1,867.5	436.6	329.5	3.9	277.0	168.2	9.2	(50.1)	3,041.8

All of Nalcor's physical assets are located in the province and all revenues are generated in Canada.

22. COMMITMENTS AND CONTINGENCIES

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

(b) The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but that further monitoring be carried out. Monitoring was performed throughout 2010 with no remediation required. However, the 2010 sampling did indicate some increase in PCB concentrations in sediment and fish flesh in specific locations, and an increased frequency of monitoring was recommended. Further sampling has now been scheduled for 2013.

(c) Hydro has entered into power sales agreements with third parties. To facilitate market access, Hydro has entered into a transmission service agreement with Hydro-Quebec TransEnergie, which concludes in 2014, to acquire access to 265 MW of transmission capacity from Labrador through Quebec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

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

2013	$18.9 million
2014	$4.7 million

(d) Nalcor and its subsidiaries have received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Nalcor's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.3 million (2011 - $0.4 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2011 - $21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action is not determinable at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately $531.8 million as at December 31, 2012 (2011 - $54.0 million). In addition, Oil and Gas has committed to fund its share of all exploration and development projects.

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

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

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

(millions of dollars)	2013	2014	2015	2016	2017
Power purchases	24.9	24.5	24.7	24.9	25.2

(g) Nalcor has issued four irrevocable letters of credit. One was issued to the Department of Fisheries and Oceans (DFO), two were issued to the Newfoundland Labrador Offshore Petroleum Board and one was issued to Newfoundland Transshipment. The letter of credit issued to DFO in the amount of $0.3 million was in connection to the operation of the hydroelectric assets on the Exploits River. The remaining letters of credit totaled $4.8 million and relate to Oil and Gas to ensure compliance with regulations relating to petroleum and natural gas exploration and production activities.

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

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

(h) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research and development project. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2012 there have been no commercial implementations.

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

23. RELATED PARTY TRANSACTIONS

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

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

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.1 million (2011 - $6.0 million) of the power produced by Churchill Falls.

(b) Hydro is required to contribute to the cost of operations of the PUB as well as the cost of hearings and applications costs. During 2012, Hydro incurred $1.5 million (2011 - $1.2 million) in costs related to the PUB of which $0.6 million (2011 - $0.6 million) was included in Accounts payable and accrued liabilities.

(c) The 2012 debt guarantee fee payable to the Province was $3.7 million (2011 - $3.9 million). Both the 2012 and 2011 debt guarantee fees were paid in full in March 2012.

(d) The Petroleum Exploration Enhancement Program (PEEP) was established as part of the Newfoundland and Labrador Energy Plan. PEEP is designed to boost new petroleum exploration in Western Newfoundland through the acquisition and assessment of seismic data. Funding for PEEP is provided by the Province and the program is administered by Oil and Gas. Total funding available under PEEP is $5.0 million over five years. There was no funding provided in 2012 (2011 - $4.5 million) and $1.8 million is included in Deferred Credits (2011 - $2.5 million).

(e) The Offshore Geoscience Data Project (OGDP) was established as part of the Newfoundland and Labrador Energy Plan. OGDP is designed to boost new offshore petroleum exploration in Newfoundland through the acquisition and assessment of seismic data. Funding for OGDP is provided by the Province and the program is administered by Oil and Gas. Total funding available under OGDP is $20.0 million over two years. In 2012, funding of $2.3 million was received from the Province (2011 - $10.5 million) of which $3.0 million has been recorded as Deferred Credits (2011 - $4.4 million).

(f) Prior to January 1, 2009, the Provincial Minister of Finance was authorized to invest any surplus from Bull Arm Fabrication's operations. Each year, the surplus or deficit from operations was credited or charged to the Distribution payable to the Province, however, there are no set terms of payment. The balance contains the accumulated results of operations of Bull Arm Fabrication since inception up to January 1, 2009, less any distributions paid to the Province. Effective January 1, 2009, earnings are to be retained and are reflected in retained earnings. As at December 31, 2012, $0.8 million (2011 - $0.8 million) of distributions payable to the Province are included in Accounts payable and accrued liabilities.

(g) During 2010, Bull Arm Fabrication received $1.0 million in funding from the Province of which $0.3 million was recognized as revenue in 2011. No grant revenue was received or recognized during 2012.

(h) Nalcor, as the operator of the Exploits assets, has a net payable to the Province of $17.4 million (2011 - $9.9 million) which is included in Accounts payable and accrued liabilities. Nalcor operates these assets on behalf of the Province on a cost recovery basis.

(i) On February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the Power Contract. To date, $1.8 million (2011 - $1.4 million) has been received and $0.2 million (2011 - $0.2 million) has been accrued as due from the Trust.

(j) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2012, $6.2 million (2011 - $5.3 million) was payable.

(k) Hydro received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2012, $1.9 million (2011 - $3.5 million) has been recorded in Deferred credits.

(l) In relation to Nalcor's financial obligations with respect to the upper Churchill Redress Agreement, the Province provided funding in the amount of $39.9 million which is recorded as Other long-term assets. This funding will be used to offset payments to the Innu Nation.

24. SUBSEQUENT EVENTS

Forward Contracts

On January 18, 2013, Oil and Gas entered into a total of 11 commodity price swap contracts with a notional value of USD $25.3 million to mitigate commodity price exposure on energy sales. These contracts provide Oil and Gas with an average fixed price of $107.45 per barrel on approximately 36.0% of the estimated production for 2013.

In January 2013, Hydro entered into a total of 12 forward contracts with a notional value of US $23.0 million to mitigate a portion of the USD exposure on recall sales through to the end of 2013. The average rate on these forward contracts was $1.01 CAD per USD.

In January 2013, Bull Arm Fabrication entered into a total of 22 forward contracts with a notional value of US $10.1 million to mitigate USD/CAD exposure on a portion of its USD denominated lease revenue. The average rate on these forward contracts was $1.01 CAD per USD.

Cancellation of letters of credit

In February 2013, Hydro cancelled 23 letters of credit related to the New Brunswick System Operator totalling $18.6 million.

Demand Operating Facility

Subsequent to the year end, Nalcor increased the credit available under its demand operating facility from $100 million to $150 million.

Equity Contribution

In each of January and March 2013, Nalcor received a contributed capital of $100.0 million from the Province.

Change in Ownership

On February 11, 2013, Emera Newfoundland & Labrador Holdings Inc. contributed $67.7 million to the LIL Partnership in exchange for 25 Class B Limited Units in accordance with the terms and conditions of the Labrador-Island Link Limited Partnership Agreement. As a result, Nalcor's ownership in the LIL Partnership changed from 100% to 65%.

Capital Commitments

Subsequent to year end, Nalcor entered into new commitments totaling $434.8 million related to the Muskrat Falls project.

25. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the 2012 financial statement presentation of regulatory accounting adjustments.

Financial Statistics

Years ended December 31 (millions of dollars)	**2012**	2011	2010	2009	2008
OPERATING RESULTS					
Revenue					
Energy sales	**710.4**	700.0	588.8	561.6	563.3
Other	**15.7**	14.1	13.3	10.3	7.0
	726.1	714.1	602.1	571.9	570.3
Expenses					
Fuels and power purchased	**243.2**	207.8	184.8	202.3	205.8
Operations and administration	**206.9**	200.1	181.9	171.3	148.2
Net finance expense	**73.6**	70.9	87.1	84.1	78.2
Amortization and depletion	**79.3**	85.2	67.5	54.9	53.2
Other income and expenses	**0.4**	(2.8)	3.3	(0.7)	-
Regulatory adjustments	**30.0**	24.1	-	-	-
Write down of assets	**-**	-	-	-	2.7
	633.4	585.3	524.6	511.9	488.1
Net Income	**92.7**	128.8	77.5	60.0	82.2
Contributions to net income					
Regulated Electricity	**17.1**	23.1	6.5	17.9	9.0
Energy Marketing	**21.2**	47.1	53.4	37.4	51.6
Churchill Falls	**28.3**	24.4	26.8	11.7	20.8
Oil and Gas	**32.7**	39.1	(2.5)	(2.4)	(0.1)
Bull Arm Fabrication	**4.2**	3.7	1.1	3.1	-
Coproate and Other Activities	**(10.8)**	(8.6)	(7.8)	(7.7)	0.9
FINANCIAL POSITION					
Total current assets	**218.6**	270.5	227.3	225.4	210.9
Total current liabilities	**508.9**	313.4	282.1	255.6	280.0
Net working capital	**(290.3)**	(42.9)	(54.8)	(30.2)	(69.1)
Property, plant and equipment	**2,950.3**	2,569.6	3,044.7	2,927.2	2,848.5
Accumulated depreciation	**515.3**	460.1	1,076.0	1,025.5	985.1
Property, plant and equipment, net	**2,435.0**	2,109.5	1,968.7	1,901.7	1,863.4
Petroleum and natural gas properties	**376.0**	304.2	269.2	193.8	112.1
Sinking funds	**302.8**	247.0	208.4	179.6	163.9
Other assets	**114.5**	110.6	131.2	130.2	124.7
Long-term debt	**1,125.9**	1,131.5	1,136.7	1,141.6	1,175.7
Other liabilities	**247.2**	167.2	120.6	91.5	84.8
Shareholder's equity	**1,564.9**	1,429.7	1,265.4	1,142.0	934.5
CAPITAL EXPENDITURES	**477.4**	253.9	196.3	178.1	205.5

Operating Statistics

Years ended December 31	**2012**	2011	2010	2009	2008
INSTALLED GENERATING CAPACITY (rated megawatts)					
Churchill Falls	**5,428**	5,428	5,428	5,428	5,428
Twin Falls	**225**	225	225	225	225
NL Hydro					
Hydraulic	**939**	939	939	939	939
Thermal	**617**	632	640	640	640
Diesel	**52**	55	58	58	56
Menihek	**19**	19	19	19	19
Total	**7,280**	7,298	7,309	7,309	7,307
ELECTRIC ENERGY GENERATED, NET (gigawatt hours GWh)					
Churchill Falls	**35,661**	33,321	33,781	30,361	34,847
NL Hydro					
Hydraulic	**4,595**	4,512	4,274	4,200	4,772
Thermal	**851**	873	792	930	1,071
Diesel	**46**	47	43	46	47
Menihek	**43**	42	37	40	41
Total	**41,196**	38,795	38,927	35,577	40,778
ELECTRIC ENERGY SALES (GWh)					
Churchill Falls Export	**30,805**	28,569	28,966	25,870	30,007
NL Hydro					
Utility	**5,359**	5,317	5,016	5,108	4,960
Rural	**998**	949	884	931	909
Industrial	**607**	491	729	576	1,124
Export	**1,559**	1,594	1,457	1,575	1,393
Menihek Export	**42**	42	37	40	41
Twin Falls Industrial	**1,740**	1,715	1,772	1,591	1,801
Total	**41,111**	38,677	38,861	35,691	40,235
TRANSMISSION LINES (kilometres)					
Churchill Falls	**1,039**	1,039	1,039	1,039	1,039
NL Hydro	**3,743**	3,742	3,742	3,742	3,742
Menihek	**39**	39	39	39	39
Total	**4,821**	4,820	4,820	4,820	4,820
PEAK ELECTRICITY DEMAND (megawatts)					
Churchill Falls	**5,671**	5,635	5,604	5,515	4,501
NL Hydro System	**1,385**	1,399	1,305	1,390	1,323
PETROLEUM AND NATURAL GAS PROPERTIES					
Oil Production (Thousands Barrels of Oil Equivalent (BOE)/day)					
White Rose Growth Lands	**1.20**	1.81	0.51	-	-
Hibernia Southern Extension	**0.44**	0.38	-	-	-
Remaining Reserves (Proven and Probable) (Millions BOE)					
White Rose Growth Lands	**3.85**	4.15	4.77	5.45	-
Hibernia Southern Extension	**20.52**	18.18	17.95	-	-
Hebron	**31.80**	30.38	-	-	-

STAFFING LEVELS					
Full-time equivalents	**1,305**	1,290	1,263	1,241	1,185

Asset Management

"If you take the definition of asset management as extracting maximum value from the assets and meeting customer service requirements ... asset management touches just about everyone in the company."

- **Scott Crosbie**, *Manager, Office of Asset Management, Nalcor Energy*

Our physical assets are the production and construction facilities, delivery systems and support equipment that enable us to deliver on our mandate. They include ownership equity in oil fields, world-class construction facilities, electrical generators, power lines, terminal stations, turbines, generators, cooling systems, pumping systems, fuel handling systems, dams, roads, transformers, environmental systems, safety systems, fleet vehicles, tools and everything in between.

Asset management is about how we integrate and apply all our resources (people, procedures, tools, spares, data, etc.) so that our assets provide the required standard of service at the optimum cost. It is how we procure, operate, maintain, rehabilitate and ultimately replace or dispose of our assets to ensure we extract maximum value across the entire life cycle while consistently providing safe, reliable and sustainable service. It is consistently operating our equipment in the way it was designed to be operated, executing our maintenance programs, using the condition of our assets to identify the right work, at the right time, and efficiently executing that work on time, on budget and with quality.

Asset Management

Successful implementation of Nalcor's robust asset management program is driven by a skilled and capable workforce. Read more about a few employes who contribute to ensuring safe, reliable operations through strategic planning and work execution.

Scott Crosbie
Manager, Office of Asset Management
Nalcor Energy

Scott Crosbie works cross-functionally with a broad group of people across all lines of business and particularly with the leads in the core roles of asset management: long-term asset planning; work execution; short-term planning and scheduling, operations and support services; as well as the asset owners who manage day-to-day operations and maintenance. He provides coaching, support, and a degree of oversight, ensuring every asset is well-managed and achieving the required performance objectives.

"Success for me is when I can look across all the areas in which we manage assets and see that we are providing the level of service and return that our stakeholders and customers expect and deserve," he says. "Success is also knowing that customers have confidence in us, that we're reliably powering the province as a whole with the lights on in homes and businesses. That we're demonstrating excellence all day, every day, in all that we do."

Bob Barnes
Manager, Engineering
Lower Churchill Project

Given that construction on the Lower Churchill Project is just getting started, "we are a long way from creating assets in the classical sense," says Bob Barnes. "That doesn't mean asset management is any less important."

As new infrastructure is built, Barnes makes sure that each piece meets Nalcor's expectations and requirements—but also that it integrates seamlessly with the existing infrastructure. "We use proven technologies, but this is a new project and technology is marching on… particularly communication and protection systems," Barnes says. "So what we build has to match and work with the Nalcor system, and it also has to be state-of-the-art."

Kris Costello

Manager, Development and Operations Oil and Gas

Asset management in the oil and gas division is different in that "we're not actually operating the assets on the front line," says Kris Costello. "But we do follow the same principle of looking to maximize value."

Costello manages and monitors Nalcor's equity stakes in offshore oil and gas developments – such as the 4.9 per cent working interest in Hebron – through the entire life cycle of the projects, from design to decommissioning. As an owner of these major assets, it's a matter of due diligence. Part of that is keeping "a view of the bigger picture, making sure that all operations align with Nalcor's corporate strategy and that all decisions are based on the principle of fairness for all stakeholders," he says.

Bob Woodman

Manager, Long-Term Planning, Hydro Generation, Hydro

Asset management is the "holistic view of what we're doing," says Bob Woodman from Bay d'Espoir, where he oversees long-term planning for hydro generation assets including reservoirs, and generating stations. With a goal of uninterrupted, cost-effective electrical service for customers, Woodman determines what preventative maintenance must be done and when; work execution then completes the work. "The key to success is teamwork," he says. "There's no way we could operate in silos."

A number of the assets under Woodman's watch are aging, so he must identify which ones need refurbishing, upgrading, or replacing—and design a capital program to ensure projects align to an optimized asset life-cycle.

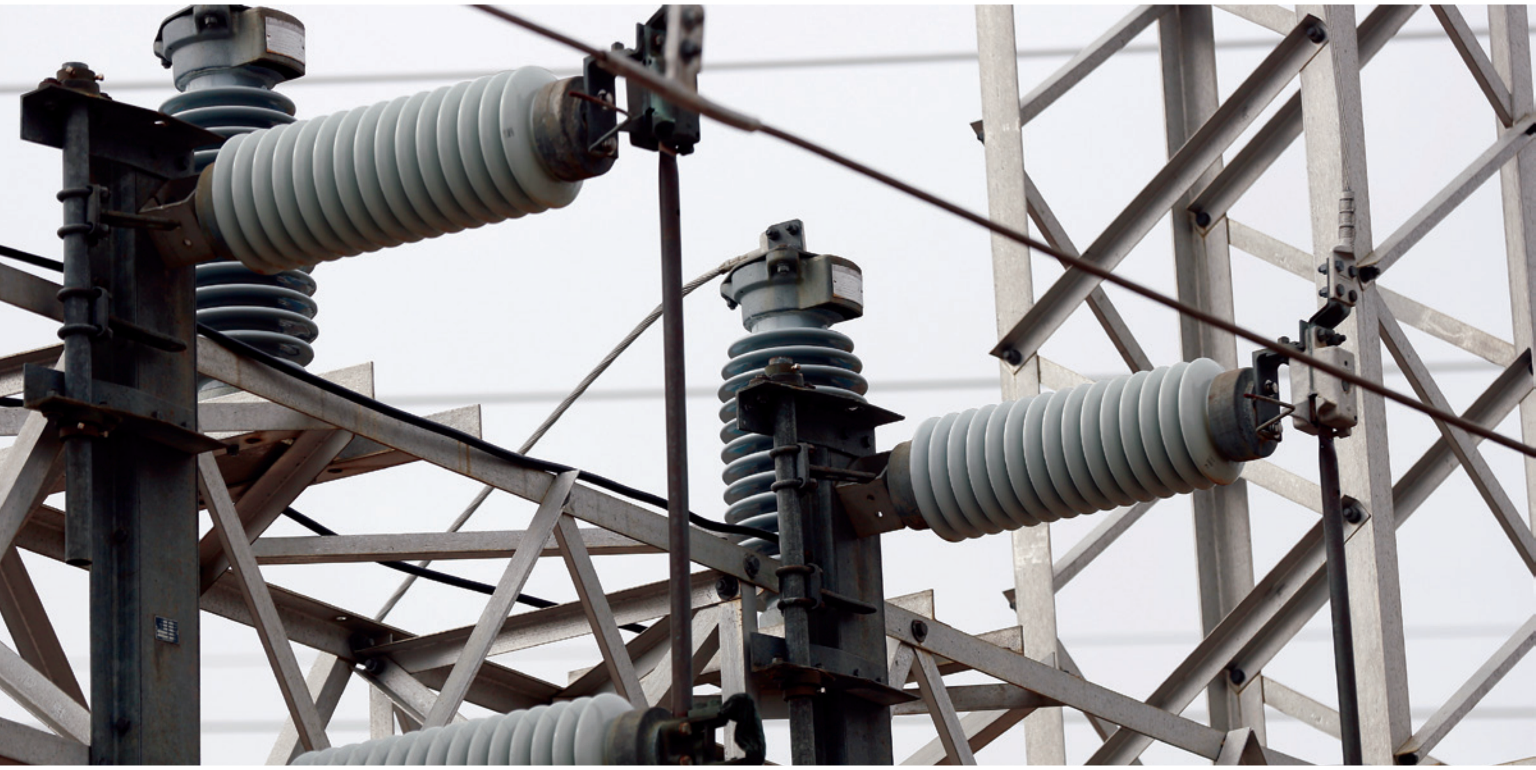
Christian Thangasamy

Plant Engineer/Mechanical, Thermal Generation, Holyrood Plant, Hydro

Bringing the aging Holyrood plant up to a more modern level of service is a challenge—but one Christian Thangasamy loves. "We have to find ways to improve what we have," he says. To do that, he researches the latest international standards and comes up with a plan to bring existing assets up to that level. It requires imagination and "a real passion" for the work.

Beyond designing plant improvements and new systems, Thangasamy develops new standards and procedures, provides input for capital planning, and finds solutions for long-standing or acute problems. All incidents at the plant are investigated through root cause failure analysis, a process of learning from issues so they will not reoccur.

Asset Management



Kirby Spence

Manager of Operations and Work Execution, Transmission and Rural Operations, Hydro

As Manager of Operations and Work Execution, Kirby Spence is responsible for executing work designated by the asset management staff. His role is to "keep an eye on the assets, to maximize the lifespan of any equipment and change it out before an equipment failure occurs."

It's a collaborative process. "It's important to know what work has to be done, to execute that work, and if we run into trouble, to liaise with the asset managers," he says. The exchange of up-to-date information about the condition of all assets is crucial for designing maintenance plans and planning for the eventual replacement of the asset. Experienced employees, with an in-depth knowledge of the machinery, offer valuable insight that can't easily be replaced.

Mike Zaichkowsky

Manager, Long-Term Asset Planning, Transmission and Distribution, Hydro

Mike Zaichkowsky's goal is to "ensure our assets are in a condition that can meet or exceed the expectations of our customers." Accomplishing that requires a number of steps: identifying the equipment he is responsible for (transmission and distribution and any related facility, including line depots and substations), determining what maintenance is required and that it is completed, constantly collecting data about the condition of the equipment, and designing long-term plans – one-year, five-year, even 20-year plans – for each asset.

"It's key to know when a piece of equipment needs to be replaced," he says. "It's a challenge. For example, there are not many tests to help determine the condition of an undersea cable; it takes research and planning."

Oral Burry

Manager, Long-Term Planning and Asset Management, Churchill Falls

At Churchill Falls, "our assets are at various conditions and stages in their life cycles," says Oral Burry. It takes careful planning and monitoring of the condition of this equipment to ensure continued safe and reliable operations.

"We have to prioritize and make sure we are putting our resources in the right place, and we need to create plans that can be executed while supplying our customers' scheduled needs."

There is a lot of equipment to keep tabs on, and Burry says the long-term plan is refreshed every few years. The key to asset management in this environment, he adds "is about the people, with their knowledge of how to maintain and operate the assets, and an open stream of communications."

Jonathan Drummond

Site Superintendent, Bull Arm Fabrication

Bull Arm currently has a major long-term tenant: the Exxon Mobil Canada properties. That means asset management at the site has two distinct purposes, says Site Superintendent Jonathan Drummond: to oversee and support the tenant's requirements;

and to continue advancing our long-term asset management and operating strategy so that when we are ready to market the site towards the end of the Hebron project, we're seen as a globally competitive fabrication site.

"Currently, Bull Arm is working closely with our tenant to ensure site assets are upgraded and modified according to Nalcor's management of change process," says Drummond. "In the long-term, we're focused on a planned and prudent approach to site planning and world-class asset management practices."

Nalcor Energy Executive Leadership Team (at Dec. 31, 2012)

Ed Martin
President & Chief Executive Officer

Derrick Sturge
Vice President
Finance & Chief Financial Officer

Gilbert Bennett
Vice President
Lower Churchill Project

Dawn Dalley
Vice President
Corporate Relations

Jim Haynes
Vice President
Regulated Operations
Newfoundland and Labrador Hydro

Jim Keating
Vice President
Oil and Gas

Chris Kieley
Vice President
Strategic Planning
& Business Development

John MacIsaac
Vice President
Project Execution & Technical Services

Gerard McDonald
Vice President
Human Resources
& Organizational Effectiveness

Nalcor Energy Board of Directors (at Dec. 31, 2012)

Terrance Styles (Chair) [1, 2]
Business Owner

Leo Abbass [3]
Mayor
Happy Valley-Goose Bay

Erin Breen [4]
Lawyer

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

Allan Hawkins [4]
Mayor
Grand Falls-Windsor

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

Ed Martin
President & CEO
Nalcor Energy

Gerald Shortall [2, 3]
Chartered Accountant
Corporate Director

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

Nalcor Energy Officers (at Dec. 31, 2012)

Terrance Styles
Chair

Ed Martin
President & Chief Executive Officer

Derrick Sturge
Vice President
Finance & Chief Financial Officer

Gilbert Bennett
Vice President
Lower Churchill Project

Dawn Dalley
Vice President
Corporate Relations

Jim Keating
Vice President
Oil and Gas

Chris Kieley
Vice President
Strategic Planning
& Business Development

John MacIsaac
Vice President
Project Execution & Technical Services

Gerard McDonald
Vice President
Human Resources
& Organizational Effectiveness

Wayne Chamberlain
General Counsel
& Corporate Secretary

Peter Hickman
Assistant Corporate Secretary

Rob Hull
General Manager, Commercial Financing

Kent Legge
General Manager, Finance
& Corporate Services

Corporate Governance

BOARD OF DIRECTORS

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

The principal functions of the Board include:

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

The Board met 21 times in 2012, in addition to Committee meetings. Director attendance at Board and Committee meetings in 2012:

Directors	Board of Directors	Audit	Corporate Governance	Compensation	Safety, Health and Environment
Number of Meetings Held	21	4	1	3	1
Terrance Styles[1]	12	3		1	
Leo Abbass[1]	11				
Erin Breen[1]	11				
Tom Clift	21		1	3	1
Allan Hawkins[1]	12				
Ken Marshall	21	4		3	
Ed Martin	21				
Gerry Shortall	20	4	1		

[1] Appointed June 2012

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

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

Corporate Governance

AUDIT COMMITTEE

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

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

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

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

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

CORPORATE GOVERNANCE COMMITTEE

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

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

COMPENSATION COMMITTEE

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

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

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

SAFETY, HEALTH AND ENVIRONMENT COMMITTEE

The Safety, Health and Environment Committee consists of three members as determined by the Board, all of whom are independent directors. The Committee is comprised of: Tom Clift (Chair), Erin Breen and Allan Hawkins. The Safety, Health and Environment Committee's primary responsibilities include:

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

INDEPENDENCE

Nalcor Energy has a Director Independence Policy consisting of:

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

POLICY ON INDEPENDENCE OF EXTERNAL AUDITORS

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

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

Corporate Governance

EXTERNAL AUDITOR'S FEES

The external auditor of Nalcor and its subsidiaries is Deloitte & Touche LLP. Deloitte has been the external auditor since 2003. Professional fees incurred in 2012 in connection with audit and audit-related service were $683,000 (2011 - $364,000) and fees related to non-audit services were $422,000 (2011 - $37,000).

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

Energy Portfolio

LEGEND

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

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PPA POWER PURCHASE AGREEMENT

nalcoenergy.com