

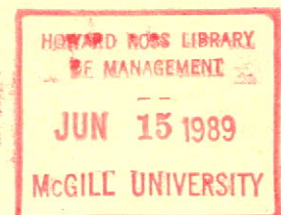


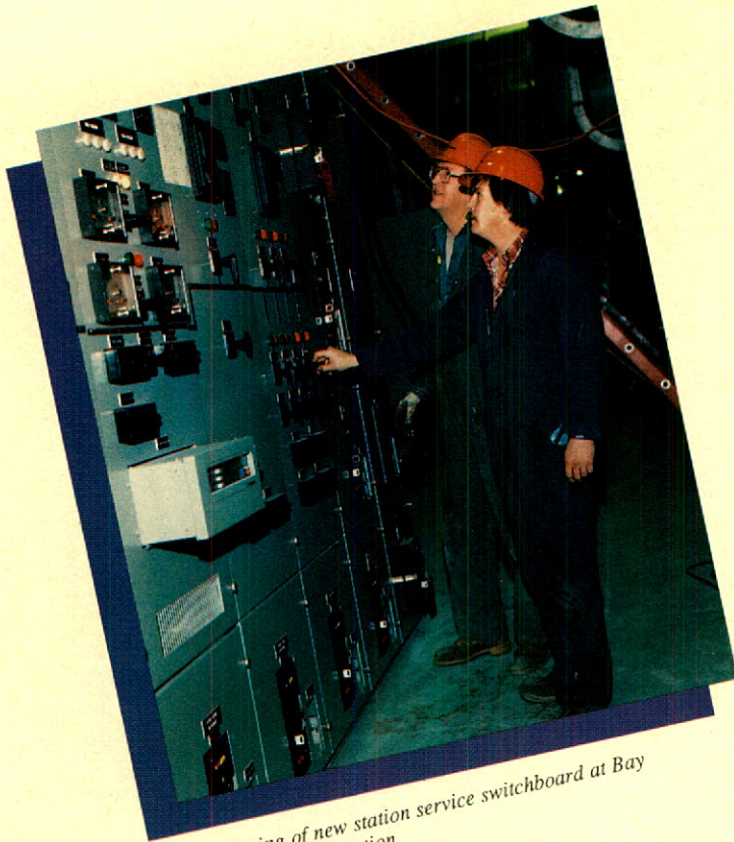
ANNUAL
REPORT
1988

Design and Production
Ted Mills & Associates Advertising Limited
Photography
Studio 2, Don Lane
Printed by
Robinson-Blackmore Printing & Publishing

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Commissioning of new station service switchboard at Bay D'Espoir generating station.

Highlights of Hydro Activities During 1988

- **Island Energy Production:** 5,658 million kW.h
- **Record Peak Demand Met:** 1,231,000 kW (Island System)
- **Construction Activity:** \$94 million
 - Commenced construction on **Hydro Place**, Hydro's new Headquarters Building and Energy Control Centre in St. John's
 - Virtually completed the **Paradise River** hydroelectric development
 - Continued progress on the wood chip-fired generating station at **Roddickton**
 - Completed the uprating on Unit No. 1 at the **Holyrood** oil-fired generating plant
 - Connected **Monkstown, Grand Bruit and Change Islands** to the Island transmission grid
- **Net Income:** \$41 million
- **Debt/Equity Ratio at Year End:** 83/17

Directors



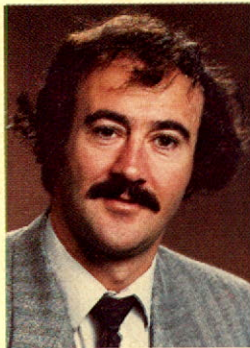
Janet C. Gardiner
Treasurer,
Chester Dawe Limited,
St. John's, Newfoundland



Lawrence D. Fahey
President,
Fahey Building Limited,
St. John's, Newfoundland



Cyril J. Abery
Chairman and Chief Executive Officer,
Newfoundland and Labrador Hydro,
St. John's, Newfoundland



Edward M. Hearn
Barrister and Solicitor,
Miller & Hearn,
Labrador City, Newfoundland



Dr. Moses O. Morgan
President Emeritus,
Memorial University of Newfoundland,
St. John's, Newfoundland



Roland T. Martin
President and Chief Operating Officer,
Keltic Incorporated,
Halifax, Nova Scotia



David W. Mercer, ex officio
President,
Newfoundland and Labrador Hydro,
St. John's, Newfoundland

Message from the Chairman and Chief Executive Officer

The Newfoundland and Labrador Hydro Group of Companies experienced another successful year in 1988.

Island electricity production totalled 5,658 million kilowatt hours, an increase of 3.5% over 1987. Continued progress was made in increasing the number of communities being served from the Island transmission grid. The communities of Monkstown, Grand Bruit and Change Islands were connected during the year and preparations were made for the connection of Fogo Island early in 1989.

Electricity costs to Hydro's retail customers decreased slightly during the year as a result of refunds from the "Rate Stabilization Plan". The rates charged to industrial customers increased slightly although the rate of increase was less than the rate of inflation. While rates were sufficient to cover the cost of service during 1988, increasing costs, because of system expansion and general inflation, will necessitate a retail rate adjustment in 1989, the first since 1985.

Our financial position was strengthened by the operating results of 1988. The Hydro Group earned a net income of \$41 million and our debt/equity ratio improved to 83/17. This further illustrates Hydro's increasing ability to reduce its reliance on capital markets by reinvesting its profits in the Corporation.

Our capital program for 1988 included the addition of generating capacity at Holyrood and the virtual completion of the hydroelectric generating station on the Paradise River. As well, having outgrown our present facilities, we commenced construction of a new Headquarters Building and Energy Control Centre. Overall, total capital expenditures amounted to \$94 million.

In 1988 we undertook intensive negotiations with Hydro-Québec regarding Labrador power. It remains our firm hope that an agreement can be reached in the near future. We could then commence development of the power potential of the Lower Churchill River for the benefit of all electricity consumers in the Province.

This annual report, in addition to giving the financial results for 1988, outlines some of the many activities performed by our employees in meeting our goal of providing reliable and stably priced electricity.

Cyril J. Abery,
Chairman and Chief Executive Officer

NEWFOUNDLAND AND LABRADOR HYDRO

As the principal generator of electricity in Newfoundland and Labrador, Hydro operates four hydroelectric generating stations (with a fifth nearing completion), a large oil-fired installation and several gas turbine and diesel plants.

Energy Production and Sales

Hydro generating plants produced 5,658 million kilowatt hours during 1988, compared to 5,432 million kilowatt hours in 1987, an increase of 3.5% (see Figure A).

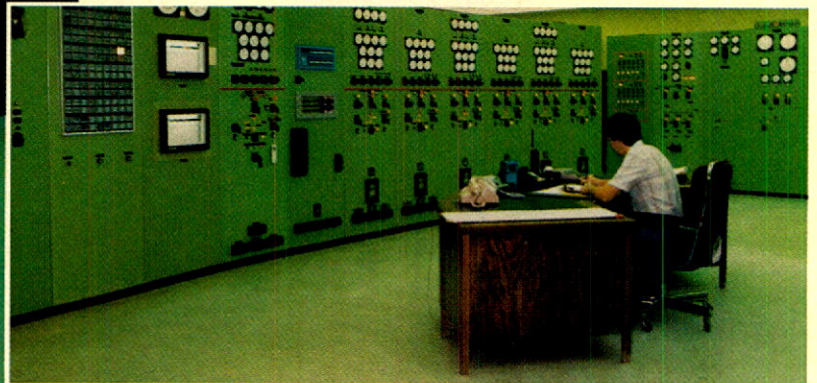
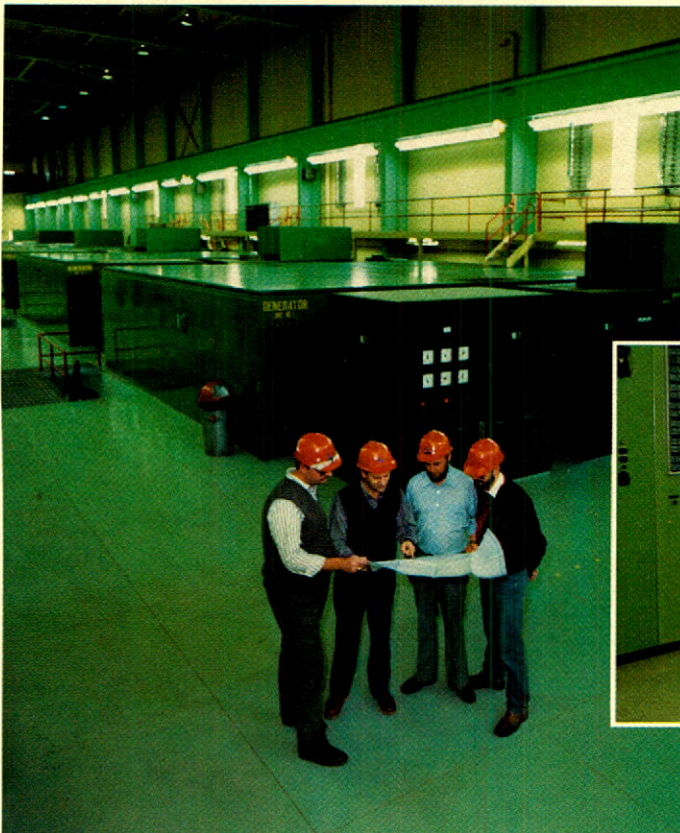
Of this total energy supplied, 73% or 4,163 million kilowatt hours was produced from hydroelectric generating stations as follows:

TABLE I

1988 ENERGY SUPPLY FROM HYDROELECTRIC GENERATION	
<i>(Millions of kW.h)</i>	
Bay D'Espoir	2,477
Cat Arm	775
Upper Salmon	527
Hinds Lake	384
	4,163

Hydroelectric production was 35% higher in 1988 than in 1987 when reservoir inflows were much lower than normal.

Thermal production for 1988 was 1,495 million kilowatt hours or 26% of our total supply (see Table II). The Holyrood generating station consumed 2.3 million barrels of Bunker 'C' fuel, producing 1,492 million kilowatt hours of electricity. Our gas turbines at Holyrood, Stephenville and near St. John's produced the remaining 3 million kilowatt hours.



Above: Control-room operator at the Bay D'Espoir generating station.
Left: Hydro plant operations staff at the Bay D'Espoir generating station.

TABLE II

**1988
TOTAL ELECTRICAL ENERGY SUPPLY**

Source of Energy	% of Total Supply	Millions of kW.h
Hydroelectric	73	4,163
Thermal	26	1,495
Purchases	1	39
	100	5,697

Our Island system met a record peak demand of 1,232,000 kilowatts on December 30, 1988. This peak is 13.4% higher than the previous record of 1,084,000 kilowatts, set in 1986. Figure B shows the ten-year growth of hydro and thermal production and the annual peaks.

Energy sales to Island customers during 1988 increased to a record 5,411 million kilowatt hours, a 3.3% increase over 1987.

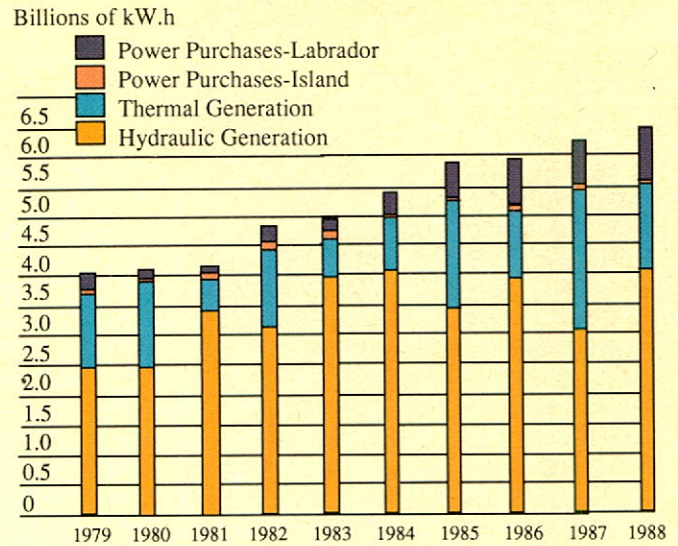
Sales of 3,843 million kilowatt hours to utility customers were 6.9% higher than in 1987 while sales of 1,568 million kilowatt hours to industrial customers were 4.6% lower than 1987. This decrease is primarily due to temporarily reduced demand by the paper mills on the Island.

Energy sales to customers in Labrador increased by 12.5% during 1988 to 661 million kilowatt hours. Industrial and secondary energy sales increased by 13% to 486 million kilowatt hours; utility sales increased by 10% to 175 million kilowatt hours. Figure C shows the ten-year growth in Island and Labrador sales.

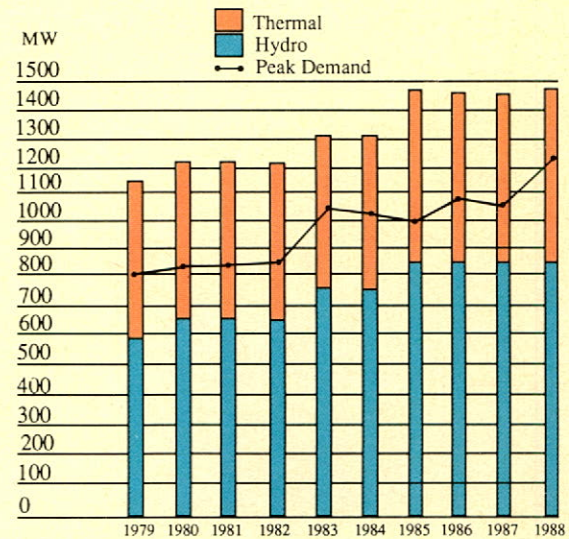
Completed and Ongoing Projects

1988 was a year of substantially increased construction activity over the previous year with total capital expenditures amounting to \$94 million versus \$37 million in 1987.

**Figure A
System Generation and Energy Purchases**

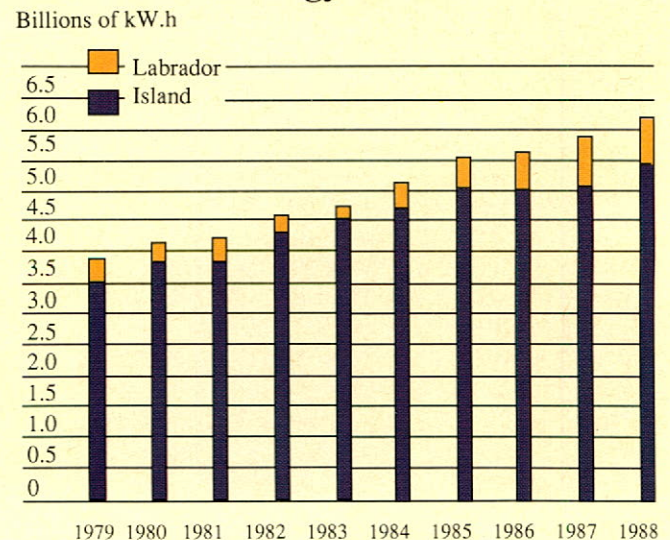


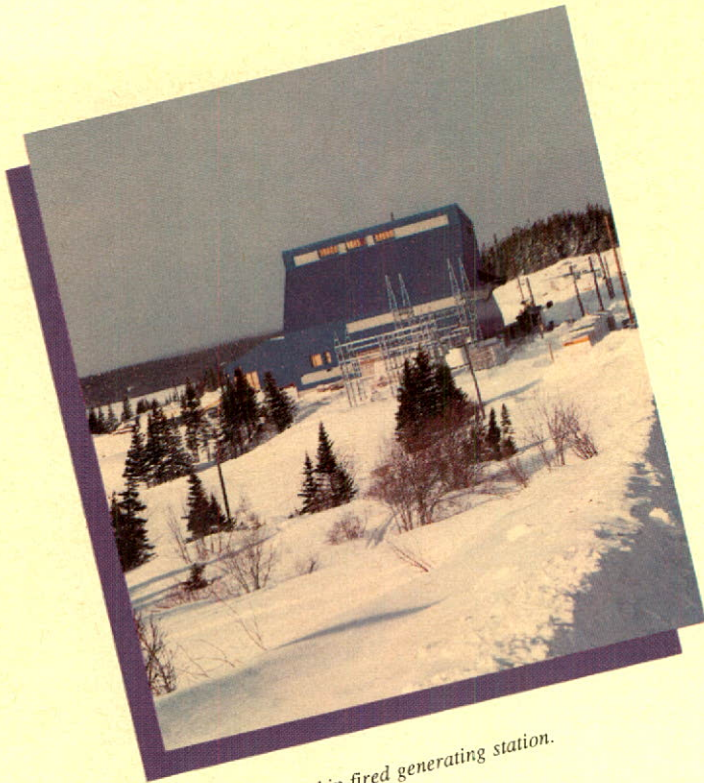
**Figure B
Generating Capacity and Demand**



Note: Excludes demand in Labrador supplied by purchased power

**Figure C
Energy Sales**





Roddickton wood chip-fired generating station.

- In the early spring, construction began on "Hydro Place", the new Headquarters Building and Energy Control Centre (ECC) in St. John's. By year end, excellent progress was recorded: the building was on schedule, for occupancy in January 1990, and within the budgeted costs of \$24 million for the Headquarters section and \$20 million for the ECC.
- Favorable progress was achieved on construction of the Paradise River hydroelectric development on the Burin Peninsula: all civil works associated with the project were essentially completed. The commissioning of the generating equipment and accessories is scheduled to begin early in 1989 and the facility is anticipated to be in service shortly thereafter. This project will add 8,000 kilowatts and approximately 37 million kilowatt hours annually to the overall generating system capability, at an estimated capital cost of \$24 million.
- Construction also progressed on the 5,000-kilowatt wood chip-fired generating plant at Roddickton, on the Great Northern Peninsula. By the end of the year, the generating station building was closed in and erection of the boiler had commenced. The in-service date will be during the late summer of 1989. To integrate the new generating station with the current systems on the northeast coast of the Peninsula, 63 kilometres of 69-kilovolt transmission line will be constructed between Roddickton and the St. Anthony airport and the Main Brook diesel plant will be closed. Of particular note is that employment in the area will be boosted: the project will result in sixteen permanent positions in the generating station and the local supply of wood fuel will create thirty-five to forty additional jobs in the forest industry. The estimated capital cost of the overall project is about \$34 million.

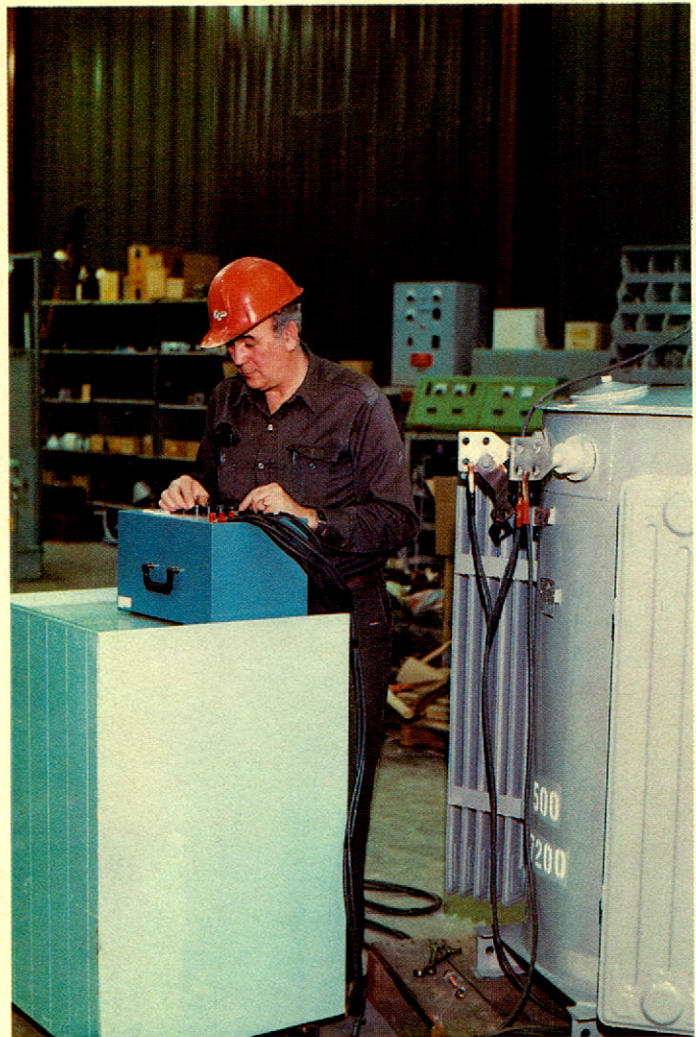


Above: New transmission and terminals service facility located at Bishop's Falls.

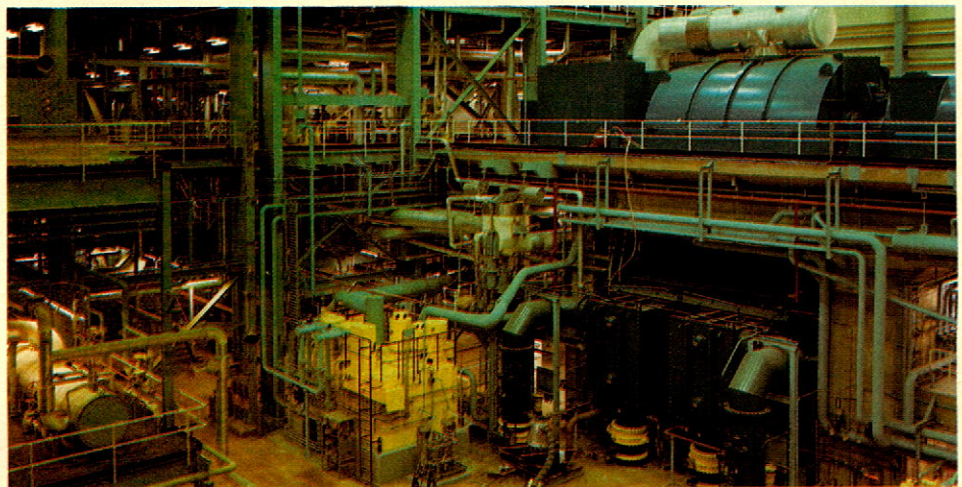
Left: Construction of the concrete arch dam at the Paradise River hydroelectric project.

- Unit No. 1 at the Holyrood thermal generating station was uprated from 150,000 kilowatts to 175,000 kilowatts during 1988, and was operational at the new rating in early December. Performance testing is scheduled for early 1989. Concurrent with the uprating, the original boiler control system was replaced by a more up-to-date computerized digital system. The cost of the uprating was approximately \$10 million.
- During the latter part of the year, engineering work associated with the uprating of Unit No. 2 at the Holyrood generating station from 150,000 kilowatts to 175,000 kilowatts commenced. Major equipment items have been ordered and project completion is scheduled for October 1989 at an estimated cost of \$10 million.
- Construction of 20 kilometres of 66-kilovolt transmission line and the installation of some 10 kilometres of 25-kilovolt submarine cables to Change Islands and Fogo connected Change Islands to the provincial power grid in November; Fogo will be connected in early 1989. Retail customers will benefit from lower electricity rates. The forecast final cost of the project is \$11 million.
- Dykes and dams on the Long Pond Reservoir at Bay D'Espoir were raised during the year to provide not only a safe routing of excessive flood waters, but also a greater degree of operating flexibility within the Reservoir.
- Throughout the year, various additions and upgradings were completed on the 230-kilovolt and 138-kilovolt transmission and terminal facilities.

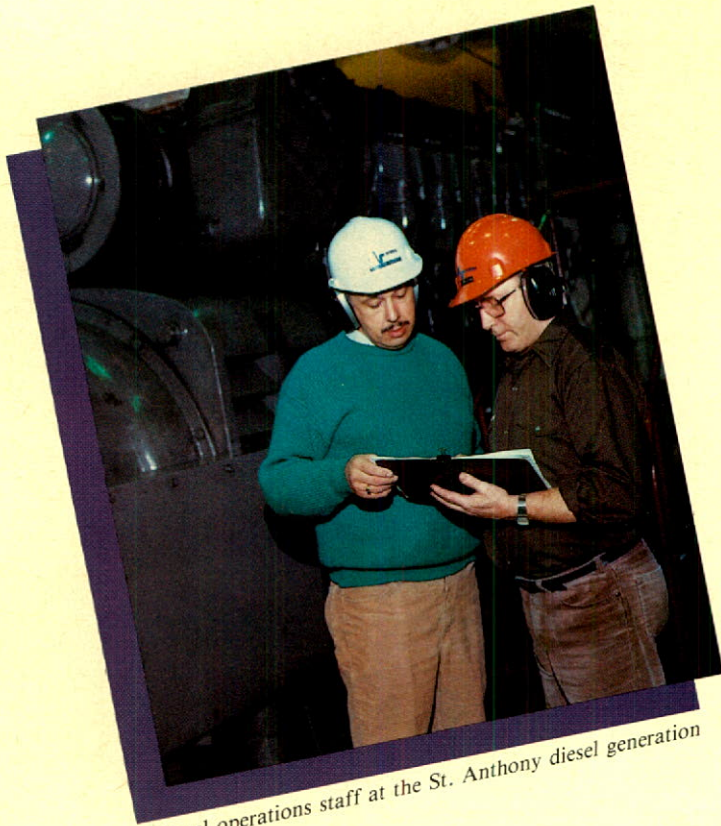
A 6.6-kilometre section of 230-kilovolt line on the Isthmus of the Avalon Peninsula was rerouted to a lower elevation and the tie-in to the existing line is scheduled for early 1989. This reroute was



Electrical equipment testing at the salvage stores centre - Bishop's Falls.



Unit No. 3, a 150,000 kW oil-fired turbine generator at the Holyrood thermal generating station.



Diesel operations staff at the St. Anthony diesel generation station.

designed to improve the reliability of the line: ice build-up, common in the area because of frequent sleet storms, will be reduced.

Harsh winter conditions affect many of our operations, and under such conditions in the early winter of 1988, several kilometres of 230-kilovolt transmission line between Buchans and Corner Brook were reconstructed after damage caused by heavy icing.

- By replacing the power turbine casings, the gas turbine generating units at Stephenville and Hardwoods, near St. John's were restored to their original nominal capacity.
- Construction on the new service building in Bishop's Falls was commenced, and virtually completed, during the year.

Future Projects

During 1988, planning was focused on the identification of generation alternatives for the Island system as well as the expansion of the provincial grid.

These alternatives included hydroelectric generation in Labrador and construction of a proposed high-voltage-direct-current transmission interconnection between Labrador and the Island.

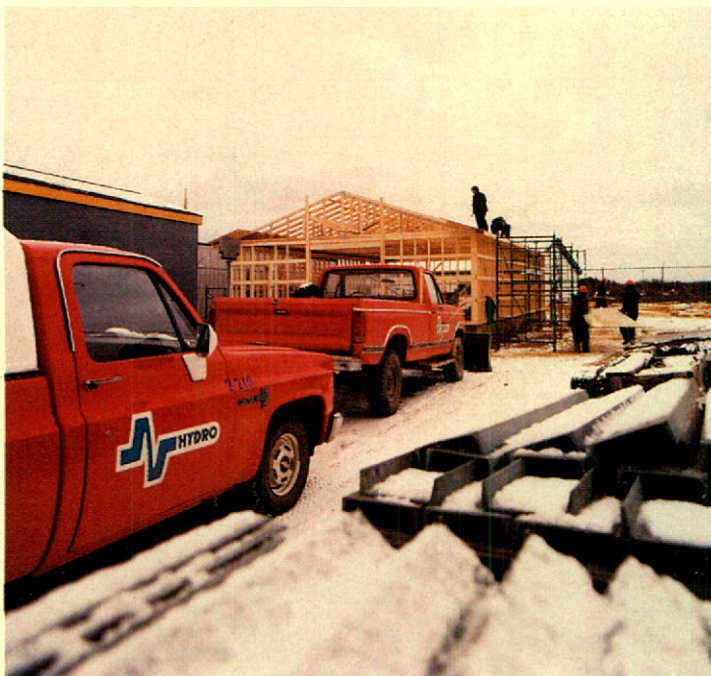
As well, engineering feasibility studies on the remaining hydroelectric sites on the Island were finalized and a preliminary siting study was carried out for a coal-fired thermal station. This four-unit plant would be located on the Avalon Peninsula.

Environment

Environmental evaluations are an integral part of the planning process at Hydro. We are committed to ensuring that all environmental concerns are adequately addressed and environmental disturbances resulting from construction activities are minimized.

- Concerns have been raised during the past several years about polychlorinated biphenyls (PCBs) in terms of their possible impact on the environment and effect on health. Hydro has established appropriate safety procedures. Our workers are trained in the safe handling of PCBs, contingency plans exist to deal with emergencies involving the chemicals, and in areas where possible, containment facilities are in place around equipment containing PCB oil so that any accidental release will be captured.

Hydro has also taken steps to ensure that the handling of PCBs conforms with all applicable



Construction of a new PCB storage containment facility at Bishop's Falls.

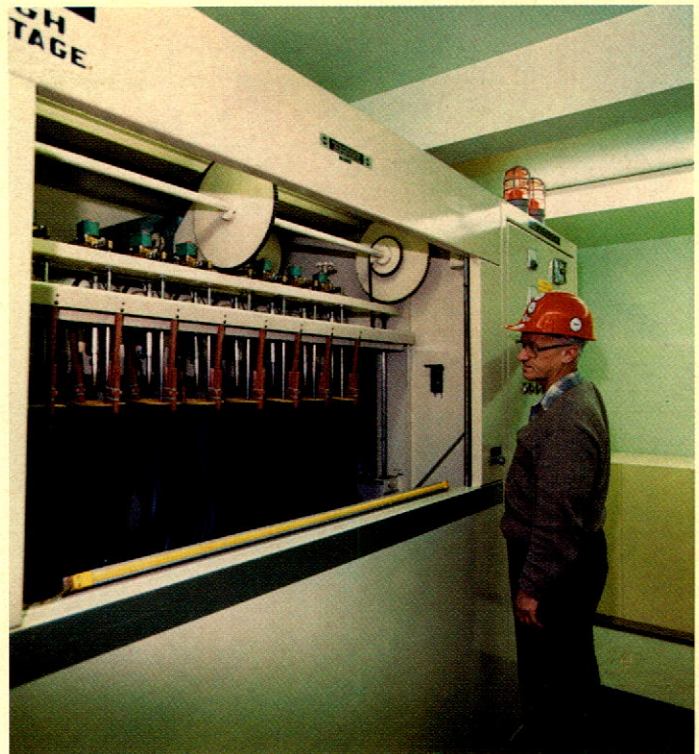
regulations and that the possibility of accidental releases of these chemicals is minimized.

PCBs are chemicals whose properties have made them useful as an insulating oil in electrical equipment, however, Hydro has initiated plans to remove all PCBs from use by the end of 1993. Requiring an investment of several million dollars, replacement equipment will be purchased and new storage facilities built and operated, in conformance with all government rules and regulations to ensure the safe storage of oil and equipment. When approved destruction facilities become available, Hydro will pursue destruction of all its PCB material.

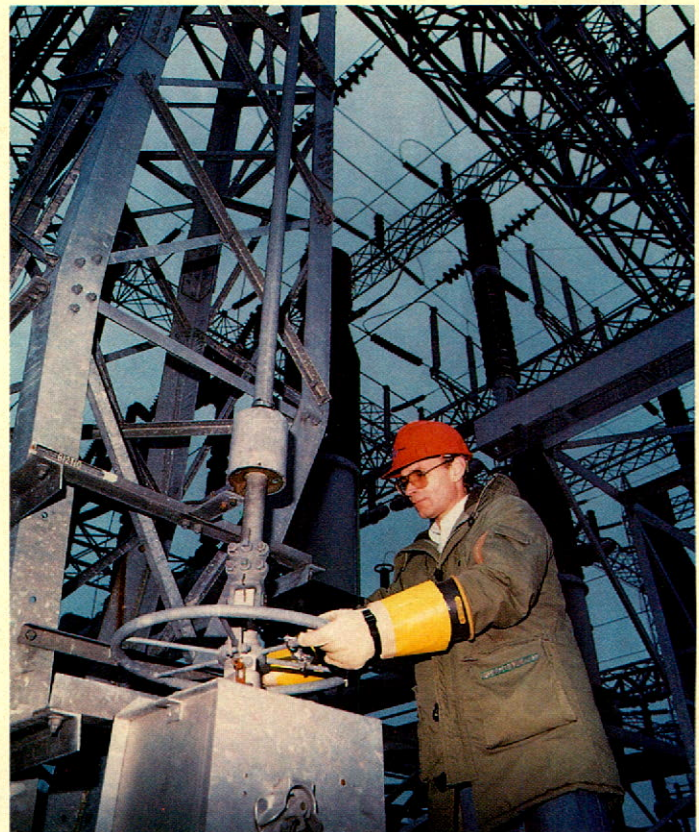
Employee Activities

A company is only as dynamic and effective as the employees who form the team. Hydro is fortunate to have a work force of dedicated individuals who together make the Corporation a success. These people can indeed be proud of the year's good results.

- Prior to year end, negotiations were concluded with Local 1615 of the International Brotherhood of Electrical Workers (IBEW), the Hydro Office Workers Unit. (A contract was ratified in January 1989, for the period ending March 31, 1991.)
- Hydro's continuing efforts to improve performance were augmented with the implementation of an "Appraisals in Action Program". Complementing the Loss Control Program, "Appraisals in Action" assists employees by demonstrating how job performance can be measured against mutually agreed upon standards and objectives.
- Also by year end, preparations were well under way to integrate all employees into the Public Service Pension Plan and to thus further improve staff mobility among the companies in the Hydro Group.
- Continued application of computer technology has seen the introduction of electronic mail and calendaring functions, as well as the extension of communication links to the area offices. Productivity improvements resulted from the subsequent ease and speed of access to information.
- Safety of employees and the public is of paramount concern in our daily operations. Accident prevention continued to receive a high priority, through the introduction of new programs and through corporate-wide performance audits.



High voltage rubber glove testing by electrical maintenance employee at Bishop's Falls.



Control room operator performing switching duties at the Bay D'Espoir switchyard.



Employee computer training at the St. Anthony office.

- Hydro was very pleased when Mr. Horace Pye, our Manager of Safety and Staff Development, was awarded the distinction, "Auditor of The Year", by The International Loss Control Institute; Mr. Pye was chosen from among 450 auditors worldwide. 1988 was the second consecutive year that this achievement was earned by a Hydro employee.
- Public safety awareness was promoted with information displays during Safety Week, through safety programs specifically designed for school children, and also through information sessions with contractors and other outside private companies.
- Hydro initiated the development of a new public service program which will be launched in 1989, with the support of law enforcement agencies and other provincial utilities. This crime prevention program, identified by the "Handy Owl" logo, will designate utility personnel as resource people who can assist the police by reporting suspected criminal activity.

The staff complement of the Hydro Group totalled 1219 at year end.

Rates Charged to Hydro Customers

The rates Hydro charged its retail customers are regulated by the Public Utilities Board, with all other rates established annually by Hydro.

- The Rate Stabilization Plan absorbs major cost variations and provides for automatic annual rate adjustments designed to amortize the balance in the plan over three years. The plan resulted in a rate reduction of 0.41 mills per kilowatt hour for retail customers in 1988. Any change due to the plan's operation that relates to industrial customers will be made in January 1989. The Plan has been working as contemplated since inception.

Hydro has not revised its rates or rate structure to retailers since 1985, however, in order to meet increasing costs it will be necessary in 1989 to file an application with the Public Utilities Board for a rate adjustment.

A blue rectangular logo with a white border, tilted at an angle. The text "CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED" is written in white, bold, sans-serif capital letters. The letter "C" is significantly larger than the other letters and partially overlaps the word "FALLS".

CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED

Hydro ranks fourth among Canadian utilities in terms of generating capacity, by virtue of its controlling interest in the Churchill Falls (Labrador) Corporation Limited, (CF(L)Co). CF(L)Co in turn operates one of the largest underground hydroelectric plants in the world, with a capacity of 5,428,000 kilowatts, at Churchill Falls, Labrador.

Energy Production and Sales

During 1988, 34 billion kilowatt hours were generated. This was 93.9% of an average production year based on historical average inflows into the reservoir system. This lower-than-average production was primarily due to low water inflows which were 83.5% of average. This was the fifth consecutive year of below average inflows. At the end of December the water levels in the Churchill Falls watershed were at a record low for that time of year.

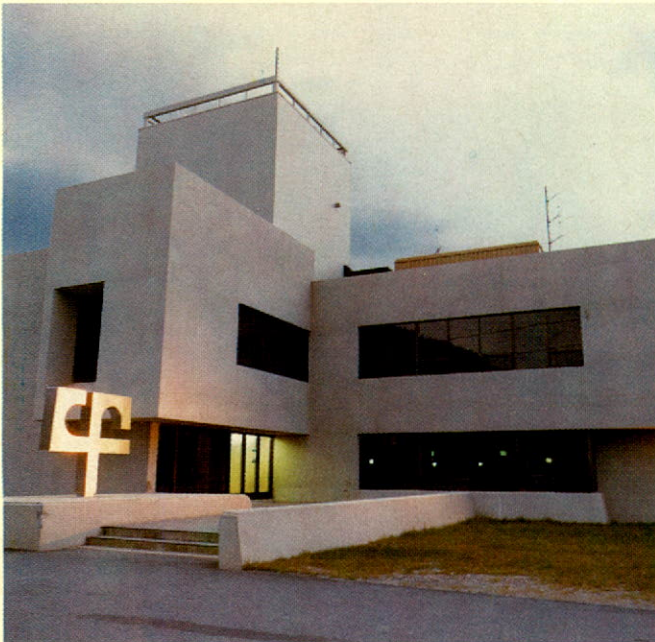
Under the terms of the power contract with Hydro-Québec, virtually all of the electricity generated by CF(L)Co is sold to Hydro-Québec; the balance is allocated to customers in Labrador for use in diverse applications which positively affect and support all aspects of today's modern society. Sales to Hydro-Québec were 30.7 billion kilowatt hours, a 1.1% increase over 1987, while sales to Labrador customers were 2.6 billion kilowatt hours, a 10.2% increase over 1987.

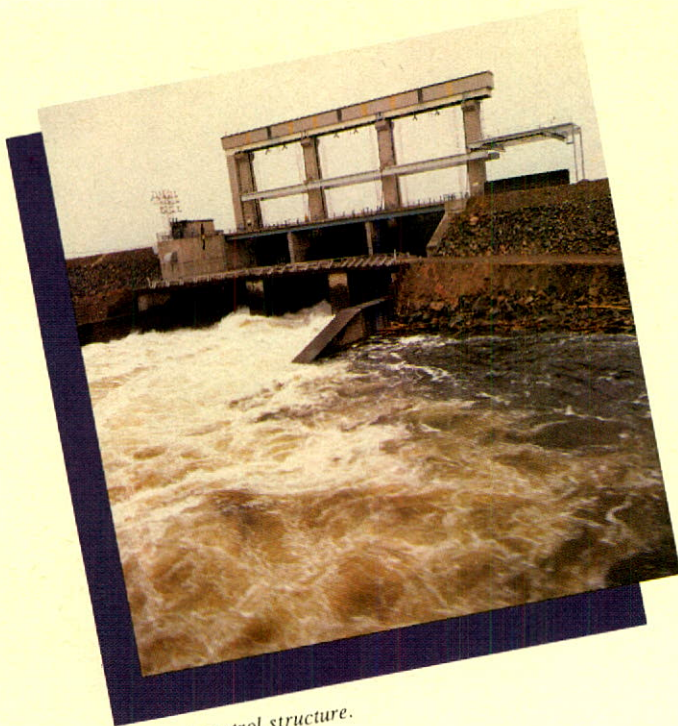
Operations

All annual inspections on the power generation equipment were conducted and completed on schedule, and the overall plant availability was increased to 91.6%, up from 89.4% in 1987.

Three 735-kilovolt circuit breakers and nine 735-kilovolt lightning arresters were replaced to complete the switchyard upgrading.

Control and Administration Building at Churchill Falls.





Lobstick control structure.

A major inspection was conducted on the centre gate rollway section of the Lobstick structure. Lobstick is the Corporation's largest control structure: through it flows an average of 50,000 cubic feet of water per second from the Smallwood Reservoir to the power plant. The inspection of Lobstick, the first undertaken since the structure was placed in service 18 years ago, indicated many years of useful life before major repairs are required. As a result, underwater inspections will now be conducted once annually, rather than twice.

During the year, the Corporation worked with the Provincial Department of Transportation which is developing plans to construct a portion of the Trans-Labrador Highway across the Ossokmanuan Reservoir. In the fall of 1988, construction started on the road from Churchill Falls to the Reservoir crossing. It is expected that the crossing, as well as the road to Labrador City, will be completed by 1991.

Employee Activities

Collective Agreements between Local 2351 of The International Brotherhood of Electrical Workers (IBEW) and CF(L)Co were renegotiated for a period ending December 31, 1990. These agreements cover members of the Operations and Office/Support Workers Units.

The Corporation provides residential and recreational facilities for all of its employees at Churchill Falls. The enthusiasm and dedicated volunteer activities of these workers and their families have made the recreational facilities an unqualified success. As a fitting tribute to their efforts, in 1988 athletes from Churchill Falls represented the Province in the Air Canada Cup Atlantic AAA Midget Hockey Playoffs, as well as at the Canada Winter Games figure skating and table tennis events.

Town of Churchill Falls.



THE BOARD OF TRUSTEES OF THE POWER DISTRIBUTION DISTRICT

The Power Distribution District of Newfoundland and Labrador (PDD) is managed by Newfoundland and Labrador Hydro on behalf of the Provincial Government. PDD is responsible for the "Rural Electrification Program" within the Province to ensure electrical service is supplied to remote areas of Newfoundland and Labrador.

PDD serves 75,000 people by distributing electricity to 28,200 customers in approximately 200 rural communities. PDD's power is either purchased from Hydro's transmission grid, wherever interconnection is feasible, or produced from 34 local diesel generating stations.

Revenue from PDD's customers is not sufficient to meet its high operating costs. Consequently, the Provincial Government provides a subsidy to PDD to make up the shortfall. At present, this subsidy is approximately \$23 million annually.

Energy Production and Sales

During 1988, PDD purchased 81% of its energy requirements from Hydro; the remaining 19% was produced from diesel generation. Overall sales increased by 12%.

In 1988, sales by PDD to its 18,900 interconnected customers on the Island and in Labrador, were 415 million kilowatt hours: an increase of 16% over 1987. Sales to the remaining 9,300 customers on PDD's isolated diesel systems reached 92 million kilowatt hours. This represents a decrease of 3.4% from 1987, due to the connection of three diesel systems to the Island grid in late 1987 and 1988.

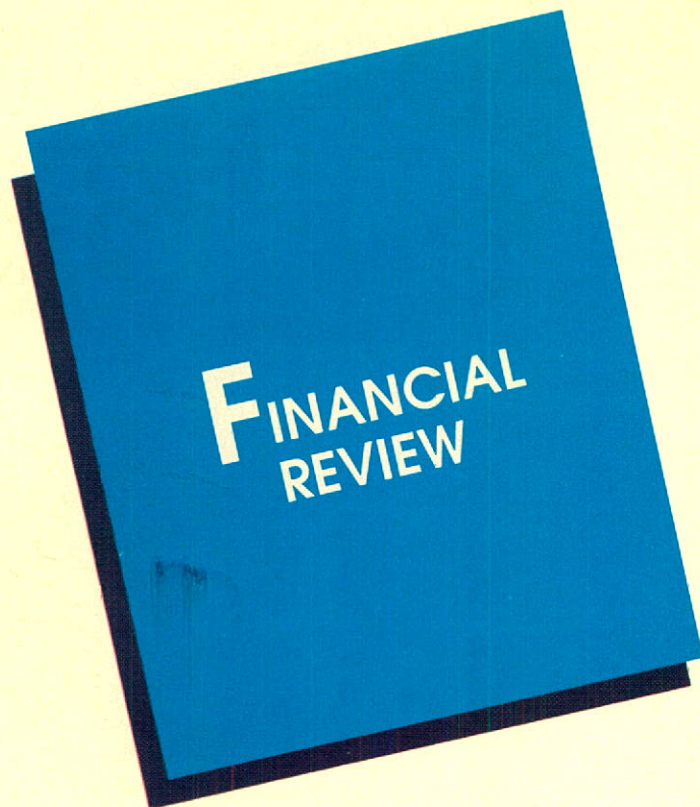
Projects

During 1988, the communities of Monkstown, Grand Bruit, and Change Islands were connected to the Island transmission grid and their diesel-generating stations were consequently closed. Approximately 320 customers in these communities are now able to take advantage of the lower rate structure applicable to energy supplied from the grid.

Capital expenditures on PDD projects for 1988 were \$33.4 million, compared with \$7.2 million in 1987. Of this, \$18.2 million was spent on generating facilities (primarily the Roddickton plant) and \$13.9 million was spent on upgrading and extending the distribution systems to meet the increasing power demands of customers.

Parson's Pond.





Consolidated Financial Performance (Hydro and CF(L)Co)

Net Income

Hydro's consolidated net income for 1988 amounted to \$41.2 million, a decrease of \$2.2 million from 1987. While sales revenue remained at the same level as that of 1987, expenses in 1988 for operations, administration and fuel were higher and only partly offset by the lower interest expense. In 1988 Hydro earned revenue from its utility customers that was slightly above the approved level and will consequently refund approximately \$1.6 million to those customers early in 1989.

Figure 1 shows consolidated net income for the past five years.

Revenue

Gross revenue for 1988 was \$332.1 million compared with \$332.3 million in 1987. Sales volume to utility customers in 1988 increased by 7% over 1987 while revenue increased by 4.7% or \$7.6 million. The volume of sales to industrial customers in 1988 was virtually unchanged from the 1987 level but revenue decreased by 8.5% or \$6.1 million since emergency energy sales in 1987 were replaced by firm energy sales in 1988.

Export sales volume from CF(L)Co increased 1.1%, however, revenue decreased by \$1.5 million because 1987 included the effect of a retroactive increase to the price of power.

Figure 2 shows consolidated revenue for the past five years.

Expenses

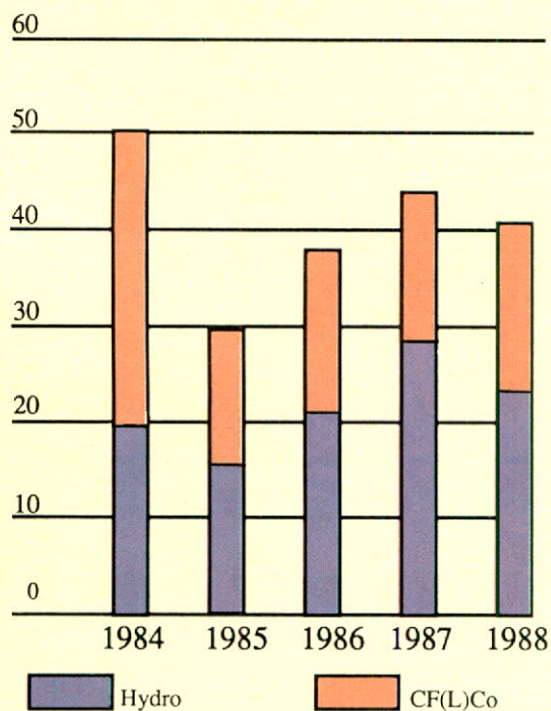
Total expenses for 1988 amounted to \$282.2 million compared with \$279.7 million in 1987, an increase of 0.9%.

The total cost of fuel and purchased power was \$71.3 million in 1988, an increase of \$9.5 million over 1987. This increase was the result of an increased volume of firm energy sales. Operations and administration costs amounted to \$59.4 million in 1988, an increase of \$4.5 million from 1987. This increase of 8.2% is primarily related to placing new facilities in service and escalation of labour and other costs.

Figure 1

Consolidated Net Income

(Millions of dollars)



Depreciation expense amounted to \$24.3 million in 1988, an increase of \$1.4 million or \$6.1% over 1987 because additional facilities were placed in service in 1988.

Net interest expense amounted to \$127.2 million in 1988 compared with \$140.1 million in 1987. The decrease of \$12.9 million results from the full year's effect of having retired high coupon debt combined with lower interest and foreign exchange rates, and also because 1987 included the effect of a retroactive adjustment to the sharing of past foreign exchange losses between CF(L)Co and Hydro-Québec.

Figure 3 shows consolidated expenses for the past five years.

Capital Expenditures

Additions to property, plant and equipment in 1988 amounted to \$93.8 million compared with \$36.9 million in 1987. The 1988 additions involved increasing generating capacity as well as additions to transmission and distribution facilities. A major portion of the 1988 expenditures involved the uprating of Unit No. 1 at the Holyrood thermal generating station, and construction of the Roddickton wood chip-fired generating plant and the Paradise River hydroelectric generating station.

CF(L)Co

As was the case in 1987, CF(L)Co's net income had a positive effect on Hydro's investment in that Corporation as follows:

	1988	1987
	<i>(millions of dollars)</i>	
Share of earnings ...	21.7	21.7
Rental and royalty ..	4.9	5.0
	<u>26.6</u>	<u>26.7</u>
Less: Interest on debt financing the investment	9.9	11.2
Net income effect	<u>16.7</u>	<u>15.5</u>

During 1988 CF(L)Co paid dividends of \$21.9 million to Hydro and \$8.3 million to Hydro-Québec. These compare with the 1987 dividend payments of \$21.1 million and \$8.2 million respectively.

Figure 2

Consolidated Revenue

(Millions of dollars)

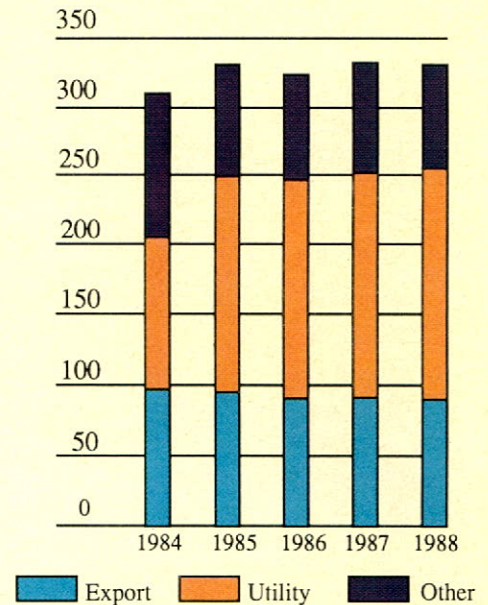


Figure 3

Consolidated Expenses

(Millions of dollars)

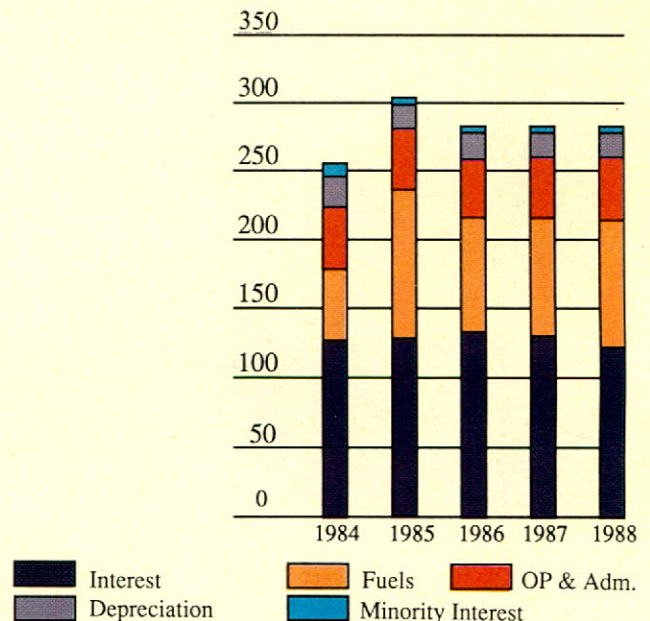


Figure 4

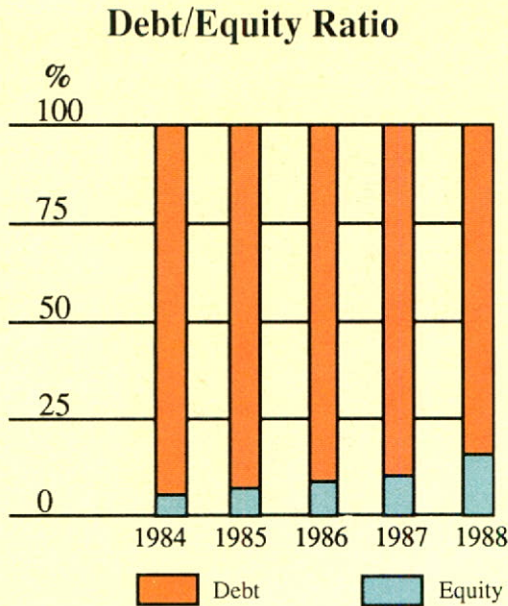
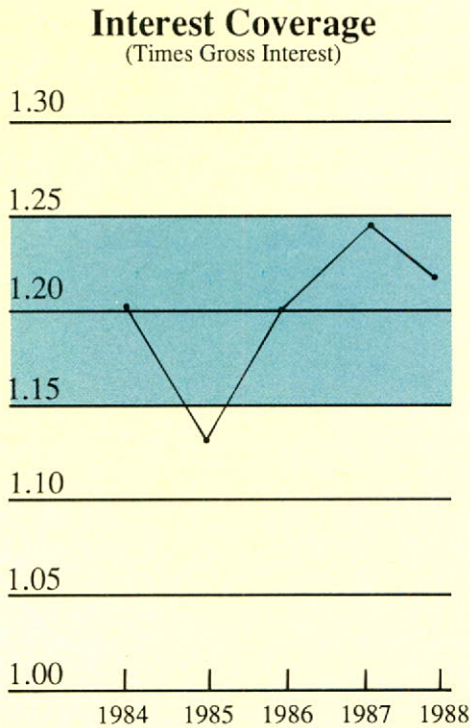


Figure 5



Segmented information for 1988 is detailed in the following table:

	Hydro	CF(L)Co	Total
	<i>(millions of dollars)</i>		
Revenue	236.5	93.2	329.7
Expenses:			
Operations & Administration ..	33.2	26.1	59.3
Fuels	70.9	—	70.9
Power			
Purchased	3.2	—	3.2
Depreciation	9.8	13.3	23.1
Interest	94.9	22.1	117.0
	212.0	61.5	273.5
Net Operating Income	24.5	31.7	56.2
Interest on CF(L)Co Acquisition & Other Dedicated Costs	—	(6.2)	(6.2)
Minority Interest	—	(8.8)	(8.8)
Net Income to Hydro	24.5	16.7	41.2

Financial Performance of Newfoundland and Labrador Hydro

Hydro's financial position continues to improve as a result of continued favorable operating results. Hydro's net income for 1988 was \$41.2 million compared with \$43.4 million in 1987. Hydro's debt/equity ratio was 83/17 at December 31, 1988 compared with 86/14 in 1987. Figure 4 shows the steadily improving debt/equity ratio of Hydro for the past five years.

Debt by Currency

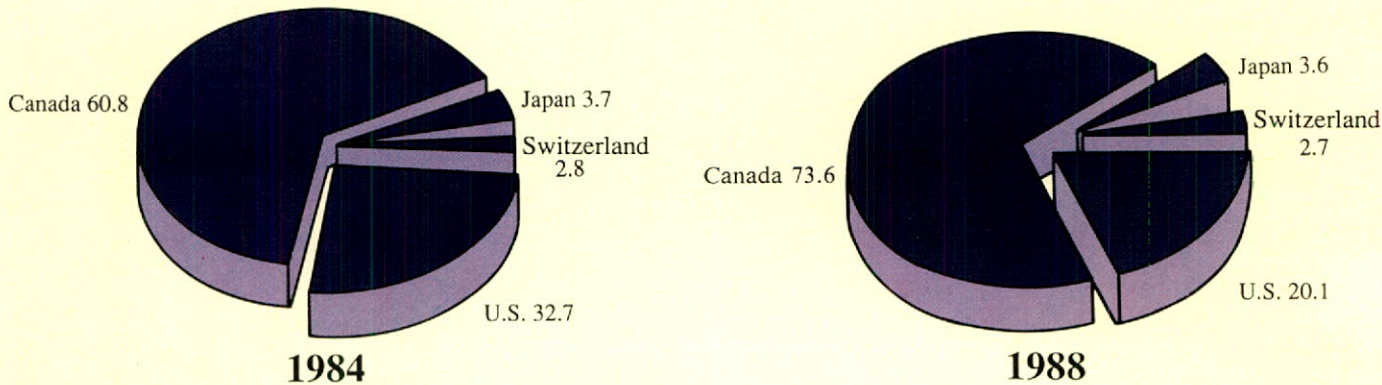


Figure 6

The regulatory authority for Hydro, the Public Utilities Board, has approved an interest coverage range within which Hydro is permitted to earn a return from its retail customers. Hydro sets industrial rates consistent with the guideline established by the Public Utilities Board for retailers. Hydro earned an overall interest coverage of 1.22 in 1988. Except for 1985, in the past five years Hydro has remained within the range of 1.15 to 1.25, as established by the Public Utilities Board. Figure 5 summarizes Hydro's recent interest coverage levels.

Hydro has decided to reduce its exposure to exchange losses on foreign debt by borrowing in the Canadian capital market when feasible. In the past five years the proportion of Canadian debt to total debt has increased from 60.8% to 73.5% as shown in Figure 6.

The net book value of Hydro's assets in service during the past five years is shown in Figure 7.

Financial Performance of CF(L)Co

Revenue from energy sales in 1988 amounted to \$91.6 million compared with \$93.4 million in 1987, although energy sales volume in 1988 was 34 billion kilowatt hours compared with 33.4 billion kilowatt hours in 1987. Energy sales volume to Hydro-Québec in 1988 amounted to 30.7 billion kilowatt hours compared to 30.4 billion kilowatt hours in 1987. Figure 8 shows the composition of total revenue for the past five years.

Energy sales revenue in 1988 was lower than 1987 because during 1987 an agreement was reached with Hydro-Québec to increase the price of power sold to them. A resulting retroactive adjustment was recorded in 1987 and no such adjustment was required for 1988.

Total expenses for 1988 amounted to \$61.6 million, a decrease of \$1.3 million from 1987. The most significant decrease was with respect to net interest and exchange expense. The 1987 net interest and exchange expense was higher in part because of the aforementioned settlement with Hydro-Québec which also changed the basis on which foreign exchange losses are to be shared.

Net income for 1988 amounted to \$31.6 million compared with \$32.1 million in 1987.

CF(L)Co paid common dividends of \$24.3 million in 1988 compared with \$23.9 million in 1987. In addition, a preferred Class A dividend of \$6 million was paid in 1988 compared with \$5.3 million in 1987.

Figure 7

Net Book Value of Hydro's Assets in Service

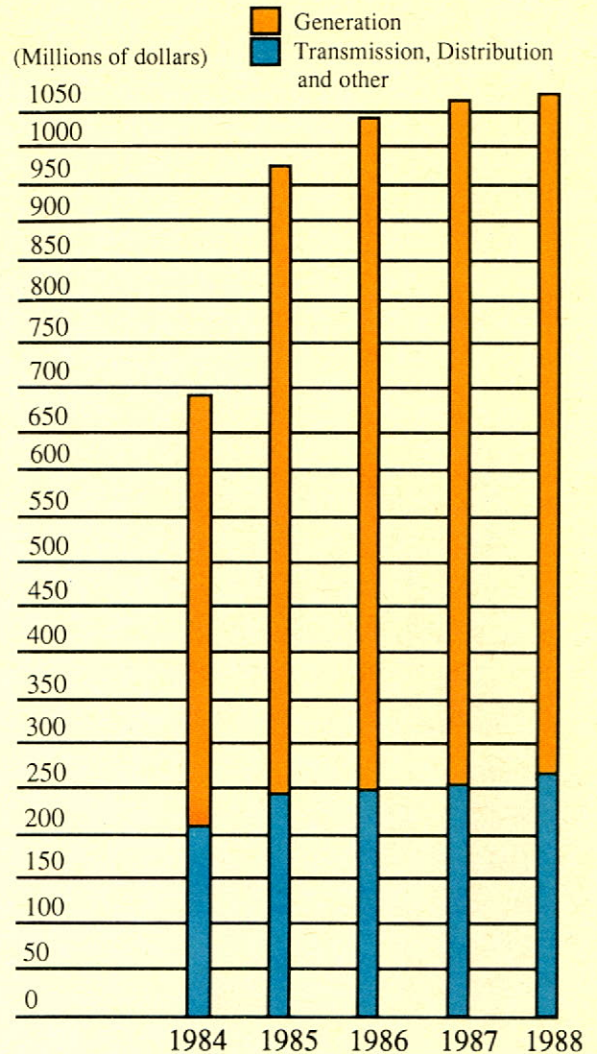
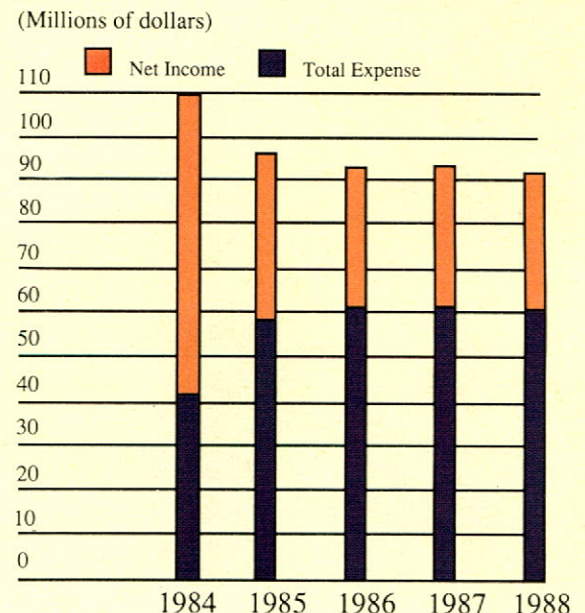


Figure 8

Composition of CF(L)Co Total Revenue



MANAGEMENT REPORT

The consolidated financial statements of Newfoundland and Labrador Hydro and all information in the Annual Report are the responsibility of Management and have been approved by the Board of Directors.

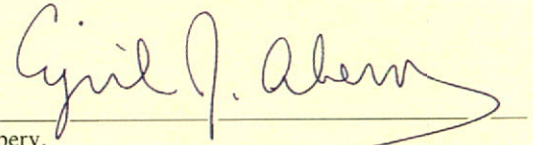
The financial statements have been prepared by Management in accordance with accounting principles generally accepted in Canada, applied on a basis consistent with that of the preceding year. Management is also responsible for the integrity and objectivity of the data in these financial statements including estimates and judgments, particularly when transactions affecting a current period are dependent upon future events. The financial statements have been prepared within reasonable limits of materiality and in light of information up to March 15, 1989. The financial information contained elsewhere in this Annual Report is consistent with the consolidated financial statements.

To assist Management in the discharge of these responsibilities, a system of internal control is maintained which is designed to provide reasonable assurance at reasonable cost that its assets are safeguarded from loss or unauthorized use, that transactions are executed in accordance with Management's authorization and that the financial records are reliable for preparing timely financial information. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. The 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 consolidated financial statements have been examined independently by the external auditors, Peat Marwick, whose responsibility it is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditors'

Report, attached to the financial statements, outlines the scope of their examination of the Company and contains their opinion on the financial statements.

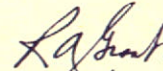
The Board of Directors carries out its responsibilities for the financial statements primarily through its Audit Committee which is comprised solely of outside directors. The Audit Committee meets periodically with Management as well as with the internal and external auditors to satisfy itself that each group is properly discharging its responsibilities, and to review the 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, to discuss auditing, internal control, accounting policy and financial reporting matters.



Cyril J. Abery,
Chairman and Chief Executive Officer



David W. Mercer,
President



R. Andrew Grant,
Vice-President, Finance and
Chief Financial Officer

AUDITORS' REPORT

The Lieutenant-Governor in Council
Province of Newfoundland

We have examined the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 1988 and the consolidated statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1988 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

St. John's, Newfoundland

Canada

March 15, 1989



Chartered Accountants

NEWFOUNDLAND AND LABRADOR HYDRO

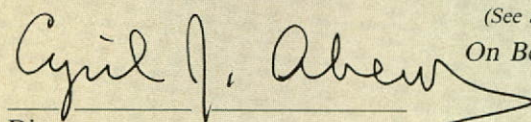
Consolidated Balance Sheet

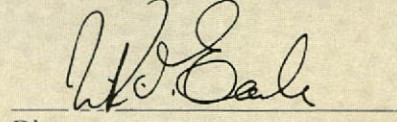
December 31, 1988, with comparative figures for 1987

	1988 (\$000)	1987 (\$000)
Assets		
Fixed assets (Note 2)		
Property, plant and equipment	1,980,466	1,913,362
Current assets		
Cash and term deposits	46,930	45,199
Receivables	53,912	60,136
Fuel and supplies at average cost	27,788	30,540
Prepaid expenses	5,256	2,786
	133,886	138,661
Long-term receivable (Note 3)	11,759	16,613
Rate stabilization plan	—	15,349
Investment in Twin Falls Power Corporation Limited (Note 4)	3,686	3,733
Lower Churchill option (Note 5)	5,200	5,200
Deferred charges (Note 6)	50,480	53,602
	2,185,477	2,146,520
Liabilities and Shareholder's Equity		
Long-term debt (Notes 8 and 9)	1,389,372	1,346,698
Current liabilities		
Accounts payable and accrued liabilities	41,935	23,538
Water equalization refundable (Note 10)	—	5,642
Accrued interest	32,958	30,169
Long-term debt due within one year	39,302	78,173
Promissory notes (Note 9)	84,855	126,100
	199,050	263,622
Rate stabilization plan	19,168	—
Minority interest in Churchill Falls (Labrador) Corporation Limited	104,047	103,572
Minority interest in Lower Churchill Development Corporation Limited	14,750	14,750
Shareholder's equity		
Share capital		
Common shares of par value of \$1 each. Authorized 25,000,000 shares; issued 22,503,942 shares.	22,504	22,504
Contributed capital (Note 5)		
Lower Churchill Development	15,400	15,400
Muskrat Falls Project	2,165	2,165
Gull Island Project	100,000	100,000
Retained earnings	319,021	277,809
	459,090	417,878
	2,185,477	2,146,520

(See accompanying notes)

On Behalf of the Board


Director


Director

NEWFOUNDLAND AND LABRADOR HYDRO

Consolidated Statement of Income and Retained Earnings

For the year ended December 31, 1988,
with comparative figures for 1987

	1988 (\$000)	1987 (\$000)
Revenue		
Energy sales	324,935	325,421
Rentals and royalties	5,586	5,736
Other	1,612	1,137
	<u>332,133</u>	<u>332,294</u>
Expenses		
Operations and administration	59,370	54,927
Fuels	70,895	61,351
Power purchased	435	433
Depreciation	24,279	22,929
Interest (Note 11)	127,172	140,102
	<u>282,151</u>	<u>279,742</u>
Net income from operations	49,982	52,552
Minority interest	8,770	9,143
Net income for the year	41,212	43,409
Retained earnings, beginning of year	277,809	234,400
Retained earnings, end of year	<u>319,021</u>	<u>277,809</u>

Consolidated Statement of Changes in Financial Position

For the year ended December 31, 1988,
with comparative figures for 1987

	1988 (\$000)	1987 (\$000)
Operating activities		
Net income from operations	49,982	52,552
Add (deduct) items not involving a cash flow		
Depreciation	24,279	22,929
Amortization of deferred exchange loss	2,630	1,551
Other amortization	2,553	2,655
Rate stabilization plan	34,517	(17,456)
Other	(1,054)	(522)
	<u>112,907</u>	<u>61,709</u>
Miscellaneous	2,614	2,136
Reduction in water equalization	—	(5,642)
Reduction in long-term receivable	4,854	4,384
Net change in other non-cash working capital balances related to operations	<u>11,988</u>	<u>(21,562)</u>
Cash provided by operating activities	132,363	41,025
Investment activities		
Additions to deferred charges	(4,161)	(15,124)
Additions to property, plant and equipment	(93,796)	(36,854)
Dividends received from Twin Falls Power Corporation Limited	900	777
Net change in payables and receivables relating to investing activities	<u>10,062</u>	<u>3,906</u>
Cash used in investment activities	(86,995)	(47,295)
Financing activities		
Issue of long-term debt	100,000	100,000
Reduction in long-term debt	(94,097)	(180,616)
Dividends paid by a subsidiary to a minority interest	(8,295)	(8,176)
(Decrease) increase in promissory notes	<u>(41,245)</u>	<u>95,145</u>
Cash (used in) provided by financing activities	(43,637)	6,353
Net increase in cash	<u>1,731</u>	<u>83</u>
Cash position at beginning of year	45,199	45,116
Cash position at end of year	<u>46,930</u>	<u>45,199</u>

(See accompanying notes)

NEWFOUNDLAND AND LABRADOR HYDRO

Notes to Consolidated Financial Statements

December 31, 1988

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland (the "Province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary companies are exempt from paying income taxes under Section 149(1)(d) of the Income Tax Act.

1. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles as established in Canada. In order to match revenues and costs and to conform with recommendations of the Board of Commissioners of Public Utilities ("PUB"), Hydro's accounting for foreign exchange differs from that recommended by the Canadian Institute of Chartered Accountants.

Rates and regulations (excluding sales by subsidiaries)

The rates charged by Hydro, excluding sales by subsidiaries, are governed by The Electrical Power Control Act (the "Act"). Under the Act, Hydro is required to charge rates to all its customers designed "to recover the cost of service provided by it and a margin of profit sufficient to achieve and maintain a sound financial position so that it is able to achieve and maintain a sound credit rating in the financial markets of the world". There are presently four long-term contracts with industrial customers which were entered into prior to the coming into being of the Act and which do not allow Hydro to recover costs plus a margin of profit and therefore require payments from the Province to Hydro in order to ensure that Hydro meets the requirements of the Act. These payments were \$15,688,000 for the year ended December 31, 1988 (1987 \$16,929,000).

Rates proposed for utility customers from which approximately 71.9% of Hydro's revenue is derived (1987 69.1%) are subject to public hearings, following which the PUB recommends rates to the Province. If the Province does not change the rates recommended by the PUB within 15 days, the recommended rates become effective. Should the Province approve rates which are lower than those recommended by the PUB, the Act requires the Province to enter into financial and other arrangements as may be necessary to enable Hydro to conform to the Act quoted above. The Province has accepted all rate recommendations of the PUB to date. Rates, compatible with the Act, charged to industrial customers are set by the Board of Directors of Hydro. The PUB has determined that Hydro's net income from operations should provide coverage of from 1.15 times to 1.25 times its gross interest cost in order to achieve the profit margin required by the Act. The coverage from operations in 1988 was 1.22 (1987 1.24).

Principles of consolidation

The consolidated balance sheet includes the accounts of Hydro and those of its subsidiary companies, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co"), (65.8% owned), Gull Island Power Company Limited ("GIPCo"), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador and having a rated capacity of 5,428,000 kilowatts ("kW") (the "CF(L)Co Project").

The cost of the investment in CF(L)Co exceeds the equity in the book value of the net assets acquired by \$77,148,000. This amount is assigned to property, plant and equipment and is being written off on a straight-line basis at the rate of 1½% per annum. As at December 31, 1988 \$16,201,000 (1987 \$15,044,000) had been written off.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, (the "Lease"), CF(L)Co must pay rentals and royalties to the Province annually. These rentals and royalties have been assigned to Hydro.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec with whom CF(L)Co has a long-term power contract.

GIPCo is incorporated under the laws of Canada and was established with the objective of developing the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and of constructing a direct current transmission system from Labrador to the island of Newfoundland (the "Gull Island Project"), (See Note 5).

LCDC is incorporated under the laws of Newfoundland and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (the "Lower Churchill Development"), (See Note 5).

Although CF(L)Co owns voting control (66⅓%) of Twin Falls Power Corporation Limited ("TWINCo"), its equity interest is 33⅓% and as the principal assets and credit resources of TWINCo cannot be transferred to CF(L)Co, consolidation is not considered appropriate and the investment is carried on an equity basis.

Fixed assets and depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo and LCDC

Plant under construction includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to plant under construction at rates equivalent to the weighted average cost of the most recent funds borrowed. The average rate for the year ended December 31, 1988 was 9.41% (1987 9.30%).

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation		
Hydroelectric		50, 75 and 100 years
Thermal electric		25 and 30 years
Diesel electric		20 years
Transmission		
Lines		40 and 50 years
Switching stations		40 years
Distribution System		30 years

CF(L)Co

Depreciation is provided for at a rate of 1½% per annum on a straight-line basis.

Deferred charges

Debt discount and financing expenses

These costs are, in general, amortized on a straight-line basis over the lives of the respective debt issues.

Deferred foreign exchange loss

CF(L)Co's unrealized foreign exchange loss, net of accumulated charges to income, is amortized over the remaining life of the related long-term debt.

In 1985, the PUB accepted the inclusion of realized foreign exchange losses in rates charged to customers commencing in 1986 for Hydro. Any such loss not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates set at that time.

Deferral of major repairs

Subject to the PUB's approval, costs of major repairs of an extraordinary and non-recurring nature are amortized to income over periods ranging from five to ten years commencing in the year in which they are incurred. The PUB has accepted the inclusion of these charges in determining Hydro's regulated rates.

Feasibility studies and other

These costs are amortized on a straight-line basis over a five-year period.

Rate stabilization plan

On January 1, 1986 Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan which provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. The balance in the plan on each July 1 is amortized over a three year period. Adjustments required in the retail rates to recover the amortization of the balance in the plan are automatic on July 1 of each year. Similar adjustments required in industrial rates are automatic on January 1 of each year.

Foreign currencies

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

- (a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.
- (b) At each balance sheet date monetary assets and liabilities, except for long-term debt and its related current portion, are translated using exchange rates at that date.
 - (i) In the case of Hydro, long-term debt, including current portion, is translated in accordance with rate making practices, at exchange rates prevailing when the debt was incurred. Therefore, no recognition is given in the accounts to unrealized gains or losses.
 - (ii) Under the provisions of the contract between CF(L)Co and Hydro Québec (the "Power Contract") CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual exchange rates prevailing at the settlement date of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract.

The unrealized foreign exchange loss not recoverable under the Power Contract has been deferred and is being amortized to operations over the remaining life of the debt.

- (c) Recorded gains or losses arising on foreign currencies are included with interest in the statement of income.

2. Fixed Assets

	1988 (\$000)	1987 (\$000)
Hydro		
Property, plant and equipment, at cost	1,221,381	1,171,952
Less contributions in aid of construction	86,114	78,310
	1,135,267	1,093,642
Less accumulated depreciation	103,583	92,485
	1,031,684	1,001,157
Plant under construction	70,055	21,536
	1,101,739	1,022,693
GIPCo		
Gull Island Project, at cost (Note 5)	98,290	98,443
CF(L)Co (a)		
Property, plant and equipment, at cost	967,037	964,890
Less accumulated depreciation	211,205	197,182
	755,832	767,708
LCDC		
Capital studies (Note 5)	24,605	24,518
	1,980,466	1,913,362

(a) CF(L)Co assets are pledged as security for its long-term debt.

3. Long-Term Receivable

The long-term receivable which relates to a review, as provided for in Section 8.5.2 of the Power Contract, of power supplied to Hydro-Québec by CF(L)Co bears interest at 7% per annum and is receivable over the next four years. The current portion of \$4,410,000 (1987 \$4,410,000) has been reclassified to current assets.

4. Investment in Twin Falls Power Corporation Limited

	1988 (\$000)	1987 (\$000)
Shares, at cost	2,500	2,500
Equity in retained earnings at beginning of year	1,233	1,261
Equity in net income for the year	853	749
Dividends for the year	(900)	(777)
	3,686	3,733

5. Lower Churchill Development

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

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (the "Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (the "Option Agreement"). The purchase price in respect of GIPCo's assets will be a maximum of \$100,000,000 less \$5,200,000 representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of \$94,800,000. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The Option Agreement expires November 24, 1989 and it is not anticipated that there will be any loss upon sale of GIPCo's assets to LCDC.

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

In 1980, the LCDC Board of Directors issued a report to the shareholders recommending development of the Muskrat Falls site and the transmission of this power to the island of Newfoundland. Engineering studies for the transmission system have been completed but a final commitment to the project awaits shareholders' approval.

6. Deferred Charges

	1988 (\$000)	1987 (\$000)
Debt discount	13,993	13,878
Deferred foreign exchange loss	32,932	37,662
Major repair costs	359	636
Feasibility studies and other	3,196	1,426
	50,480	53,602

7. Power Distribution District

Hydro administers the Power Distribution District of Newfoundland and Labrador ("PDD"), a statutory corporation of the Province. PDD is responsible for the provision of electricity to its customers in certain remote rural communities. Hydro finances the capital requirements of PDD, manages PDD's operating responsibilities and is fully reimbursed for all costs associated therewith.

8. Long-Term Debt

	1988			1987
	Hydro (\$000)	CF(L)Co (\$000)	Total (\$000)	Total (\$000)
Summary of long-term debt				
Bonds, notes and debentures	837,336	475,850	1,313,186	1,268,136
Government of Canada loans	76,186	—	76,186	78,562
	913,522	475,850	1,389,372	1,346,698

At December 31, 1988 it is estimated that required repayments of long-term debt over the next five years will be as follows:

	(\$000)
1989	39,300
1990	51,200
1991	43,900
1992	198,400
1993	43,600

Details of long-term debt are as follows:

Hydro

Bonds, notes and debentures, redeemable at the option of Hydro at various times and at various rates, none of which exceed 102 ¼% of par.

Series	Interest Rate %	Year of Issue	Year of Maturity	Foreign Funds	1988	1987	
				(\$000)	(\$000)	(\$000)	
	5¼	1965	1990	U.S.	8,800	9,497	11,527 (a)
	7¼	1968	1993	U.S.	25,000	26,773	26,773 (b)
	9	1969	1994	U.S.	8,700	9,353	9,837
	8%	1972	1992			15,000	15,000 (b)
	8%	1974	1999			20,000	20,000 (b)
	10%	1975	1995			25,000	25,000 (b)
	4%	1975	1992	S.Fr.	75,000	28,286	28,286
	10¼	1976	2001			30,000	30,000 (b)
	10	1977	2002			30,000	30,000 (b)
J	10	1977	2002			35,000	35,000 (b)
K	10¼	1978	2001			35,000	35,000 (b)
L	10	1978	2003			40,000	40,000 (b)
	9%	1979	1994	U.S.	50,000	57,797	57,797
M	11¼	1979	1999			110,000	110,000 (b)
N	13%	1981	2001			75,000	75,000 (b)
	15%	1982	1992	U.S.	100,000	124,072	124,072
R	11¼	1983	1988			—	50,000
	7%	1985	1995	¥	7,000,000	37,349	37,349
S	9%	1986	1996			100,000	100,000
T	10½	1987	1997			100,000	100,000 (c)
U	9%	1988	1998			100,000	— (d)
						1,008,127	960,641
Less sinking funds						150,327	126,997
						857,800	833,644
Less payments due within one year						20,464	60,061
						837,336	773,583

- (a) Secured by an assignment of amounts receivable under a power contract.
- (b) A sinking fund has been established for this issue.
- (c) The holder of any debenture has the right to elect that such debenture shall mature December 15, 1992 and Hydro has the right to increase the rate of interest on all debentures of this issue from that date to December 15, 1997.
- (d) Interest will increase to 10% on August 2, 1993. The holder of any debenture has the right to elect that such debenture shall mature on August 2, 1993 and Hydro has the right to further increase the rate of interest on all debentures of this issue from that date to August 2, 1998.

Government of Canada Loans

These loans, in the aggregate amount of \$78,562,000 (1987 \$80,782,000), including the current portions, bear interest at various rates from 5¼% to 8½% and each loan is repayable following the completion date of the related facility, by thirty or forty equal annual instalments including interest. The years of maturity of these loans range between 2003 and 2014, and the current portion as at December 31, 1988 was \$2,376,000 (1987 \$2,220,000).

Based on exchange rates in effect at December 31, 1988, the approximate amount required to discharge foreign currency debt obligations recorded in the accounts in Canadian dollars as \$293,127,000 would be \$356,720,000 (1987 as \$295,640,000 would be \$405,055,000).

CF(L)Co

	1988 (\$000)	1987 (\$000)
First Mortgage Bonds		
7¾% Series A due December 15, 2007 (U.S. \$350,336,000)	373,785	389,004
7¼% Series B due December 15, 2007	35,152	36,364
General Mortgage Bonds		
7½% due three years after latest maturity of any First Mortgage Bonds	83,375	85,077
	492,312	510,445
Less payments due within one year	16,462	15,892
	475,850	494,553

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments which commenced in June 1978.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976.

9. Guarantees by the Province

The Province has unconditionally guaranteed the principal and interest on promissory notes and long-term debt, except for the Swiss franc loan and the debt of CF(L)Co.

10. Water Equalization

In order to equalize the effect on thermal generation cost due to fluctuations in water availability, Hydro charged or credited fuel expense in the income statement annually with an amount calculated to adjust generation costs to an average annual water condition. The calculation was based on historical water flow data compiled over a period of 36 years. The offsetting debit or credit was included in the water equalization provision account. This practice was accepted by the PUB in determining Hydro's regulated rates up to December 31, 1985.

On January 1, 1986, Hydro implemented a rate stabilization plan which includes a water variation provision component and the water equalization provision was discontinued. The balance in the water equalization provision at December 31, 1985 was \$30,267,000. Of this amount, \$7,843,000 was used to extinguish a related receivable from the Government. The remainder was refunded to customers over a three year period which commenced January 1, 1986.

11. Interest Expense

	1988 (\$000)	1987 (\$000)
Gross interest		
Long-term debt	164,588	179,512
Promissory notes	7,096	4,909
	171,684	184,421
Amortization of debt discount and financing expense	1,723	1,674
Exchange loss on sinking fund transactions and retirement of debt	1,645	1,819
	175,052	187,914
Less:		
Recovered from:		
Hydro-Québec (a)	16,073	21,266
PDD	5,946	5,333
Interest during construction	2,712	1,093
Interest earned	23,149	20,120
Net interest expense	127,172	140,102

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

Also, CF(L)Co can require Hydro-Québec to make an additional cash advances to service its debt and to cover its expenses if funds are not otherwise available. In exchange CF(L)Co will issue units of Subordinate Debentures and shares of common stock.

12. Commitments and Contingent Liabilities

- (a) (i) A request was made by the Province in 1976 for CF(L)Co to supply 800,000 kW of power, pursuant to Clause 2(e) of Part I of the lease, to meet the Province's requirements commencing in 1983. This request was denied and legal action was commenced against CF(L)Co. The Newfoundland Supreme Court, Trial Division and Court of Appeal denied the Province's request. On May 22, 1986 the Supreme Court of Canada granted the Province leave to appeal this judgement and the hearing was held on May 3 and 4, 1988. On June 9, 1988 the Supreme Court dismissed the Province's appeal.
- (ii) In June 1977, Hydro-Québec commenced an action against CF(L)Co in the Superior Court in Montreal seeking a declaration as to its rights under the Power Contract should CF(L)Co comply with the Province's request referred to in Note 12(a)(i). On August 4, 1983 judgement was rendered in which the Superior Court stated that, inter alia, failure by CF(L)Co to supply Hydro-Québec all the power and energy pursuant to the Power Contract would be a breach of the Power Contract. This judgement was appealed by CF(L)Co and on February 18, 1985 the Quebec Court of Appeal rendered its judgement dismissing the appeal. On May 22, 1986 the Supreme Court of Canada granted CF(L)Co leave to appeal this judgement and the hearing was held in early May 1988. On June 9, 1988 the Supreme Court ruled that it was not necessary to deal with this appeal in view of the judgement referred to in 12(a)(i).
- (b) Under the terms of a sublease with TWINCo expiring on December 31, 1989 with an option to renew for a further twenty-five years under certain conditions, CF(L)Co is required to deliver to TWINCo, at an agreed price, horsepower equivalent to the installed horsepower of the TWINCo plant and to maintain TWINCo's plant and equipment.
- (c) Hydro has received claims instituted by various companies with respect to construction costs, outages and plant shutdowns. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately \$2,656,000 (1987 \$1,800,000). The final resolution of these matters is currently under negotiation.
- (d) Hydro's employees are covered by the Province's Public Service Pension Plan to which contributions are made equally by Hydro and its employees. The majority of CF(L)Co employees are also members of the Public Service Pension Plan and in addition, a number of employees are members of two private pension plans established by CF(L)Co. Both private plans are fully funded and managed by a Trustee. Based on the most recent actuarial valuations each private plan is in a surplus position.
- (e) Hydro's outstanding commitments for capital projects total approximately \$32,767,000 at December 31, 1988 (1987 \$20,655,000).
-

OPERATING STATISTICS

Years Ended December 31

	1988	1987	1986	1985	1984	1983	1982	1981
Installed generating capacity at end of period (rated kW in thousands)								
CF(L)Co	5,428	5,428	5,403	5,403	5,225	5,225	5,225	5,225
TWINCo.	225	225	225	225	225	225	225	225
Hydro — Hydroelectric ..	891	891	891	891	764	764	680	680
— Thermal	659	637	638	637	637	637	638	636
Total	7,203	7,181	7,157	7,156	6,851	6,851	6,768	6,766
Electric energy generated, net of station services (kW.h in millions)								
CF(L)Co	33,899	33,308	33,721	34,777	38,910	33,819	38,242	38,958
Hydro — Hydroelectric ..	4,154	3,063	3,898	3,449	4,086	3,912	3,134	3,387
— Thermal	1,412	2,245	1,255	1,725	757	575	1,121	414
Total Available for Sale.....	39,465	38,616	38,874	39,951	43,753	38,306	42,497	42,759
Electric energy sales (kW.h in millions)								
CF(L)Co — Export	30,702	30,367	30,666	31,833	35,989	31,188	35,715	35,881
Hydro — Utility	4,018	3,755	3,590	3,536	3,246	3,033	2,992	2,724
— Industrial	2,054	2,058	2,059	1,975	1,856	1,783	1,628	1,424
Total	36,774	36,180	36,315	37,344	41,091	36,004	40,335	40,029
Average sales revenue (cents per kW.h)								
CF(L) Co — Export	0.29	0.29	0.29	0.29	0.26	0.29	0.26	0.27
Hydro — Utility	4.23	4.33	4.36	4.45	3.63	3.12	2.98	2.42
— Industrial ...	3.22	3.50	3.28	3.75	3.02	2.89	2.60	2.22
Transmission Lines (kilometres)								
CF(L) Co — 735 kV	608	608	608	608	608	608	608	608
— 230 kV	431	431	431	431	431	431	431	431
Hydro — 230 kV	1,531	1,531	1,531	1,531	1,531	1,408	1,353	1,326
— 138 kV	1,073	1,039	916	916	916	916	916	845
— 69 kV	558	539	539	539	539	539	455	443
Total	4,201	4,148	4,025	4,025	4,025	3,902	3,763	3,653
Peak demand (kW in thousands)								
CF(L)Co System	5,622	5,765	5,203	5,614	5,530	5,562	5,685	5,680
Hydro System	1,232	1,065	1,084	1,009	1,013	1,040	881	834

FINANCIAL STATISTICS

(in millions of dollars)
Years Ended December 31

	1988	1987	1986	1985	1984	1983	1982	1981
Operating Results:								
Revenue								
Energy sales	324.9	325.4	314.0	323.7	268.9	236.1	225.0	195.6
Rentals and royalties	5.6	5.7	5.9	5.4	8.5	4.9	5.3	5.9
Other	1.6	1.1	0.9	1.5	*37.0	1.8	2.3	1.8
	<u>332.1</u>	<u>332.2</u>	<u>320.8</u>	<u>330.6</u>	<u>314.4</u>	<u>242.8</u>	<u>232.6</u>	<u>203.3</u>
Expenses								
Operations & administration	59.4	54.9	54.2	51.1	52.7	47.4	48.1	40.4
Fuels	71.2	61.8	53.6	95.1	49.4	31.7	40.2	17.5
Depreciation	24.3	22.9	23.0	22.9	22.3	22.2	22.4	22.1
Interest	127.2	140.1	144.2	121.4	117.0	115.4	91.2	91.7
	<u>282.1</u>	<u>279.7</u>	<u>275.0</u>	<u>290.5</u>	<u>241.4</u>	<u>216.7</u>	<u>201.9</u>	<u>171.7</u>
Net income before minority interest	50.0	52.5	45.8	40.1	73.0	26.1	30.7	31.6
Minority interest	8.8	9.1	9.3	11.0	22.1	9.7	10.6	13.0
Net income	<u>41.2</u>	<u>43.4</u>	<u>36.5</u>	<u>29.1</u>	<u>50.9</u>	<u>16.4</u>	<u>20.1</u>	<u>18.6</u>
Contributions to Net Income								
Hydro Corporate.....	24.5	27.9	22.1	15.0	19.7	14.3	16.5	10.8
CF(L) Co	16.7	15.5	14.4	14.1	31.2	2.1	3.6	7.8
Financial Position:								
Total current assets	133.9	138.6	126.7	140.4	135.4	112.3	183.4	144.3
Total current liabilities	199.0	263.6	173.0	224.2	168.5	147.0	121.2	108.2
Net working capital	(65.1)	(125.0)	(46.3)	(83.8)	(33.1)	(34.7)	62.2	36.1
Property, plant & equipment	2,295.3	2,203.0	2,167.1	2,141.8	2,108.2	2,011.9	1,864.1	1,712.4
Accumulated depreciation ...	314.8	289.6	265.3	241.5	218.4	197.5	174.8	152.4
Property, plant & equipment net	<u>1,980.5</u>	<u>1,913.4</u>	<u>1,901.8</u>	<u>1,900.3</u>	<u>1,889.8</u>	<u>1,814.4</u>	<u>1,689.3</u>	<u>1,560.0</u>
Other assets	71.1	94.5	66.8	63.7	77.7	35.8	35.2	34.1
Long-term debt	1,389.4	1,346.7	1,422.7	1,411.4	1,474.3	1,427.7	1,425.5	1,296.8
Other liabilities	138.0	118.3	125.1	130.8	151.2	129.8	119.0	111.1
Shareholder's equity	<u>459.1</u>	<u>417.9</u>	<u>374.5</u>	<u>338.0</u>	<u>308.9</u>	<u>258.0</u>	<u>242.2</u>	<u>222.3</u>
Employees at year end:								
Permanent	1,219	1,220	1,201	1,196	1,197	1,213	1,232	1,205
Temporary	215	135	132	113	107	93	95	126
Total	<u>1,434</u>	<u>1,355</u>	<u>1,333</u>	<u>1,309</u>	<u>1,304</u>	<u>1,306</u>	<u>1,327</u>	<u>1,331</u>

* Includes unusual item relating to a sale of power adjustment of \$35.3

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Roland T. Martin
Moses O. Morgan
David W. Mercer, *ex officio*

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John P. Henderson
David W. Mercer
Michael J. Monaghan, Q.C.
David S. Templeton
Jean Claude Roy
Jean Bernier

Lower Churchill Development Corporation Limited

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Charles Marriott, Vice-Chairman
David W. Mercer
Daniel E. Williams, Q.C.
Francis Fizzard

Gull Island Power Company Limited

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Leo J. Cole
R. Andrew Grant
John P. Henderson
David W. Mercer

Power Distribution District of Newfoundland and Labrador

Cyril J. Abery, Chairman
T. David Collett, Vice-Chairman
Leo J. Cole
R. Andrew Grant
Garland W. Jennings
David W. Mercer

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R. Andrew Grant, Vice-President, Finance and Chief
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Maureen P. Greene, Vice-President, General Counsel
and Corporate Secretary
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Robert D.C. Taylor, Treasurer
Peter A. Hickman, Assistant Corporate Secretary
Gerald C. Bowers, Assistant Treasurer
Mark G.S. Bradbury, Assistant Corporate Controller

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John C. Roberts, Corporate Controller
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Gerald C. Bowers, Assistant Treasurer
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Charles Marriott, Vice-Chairman

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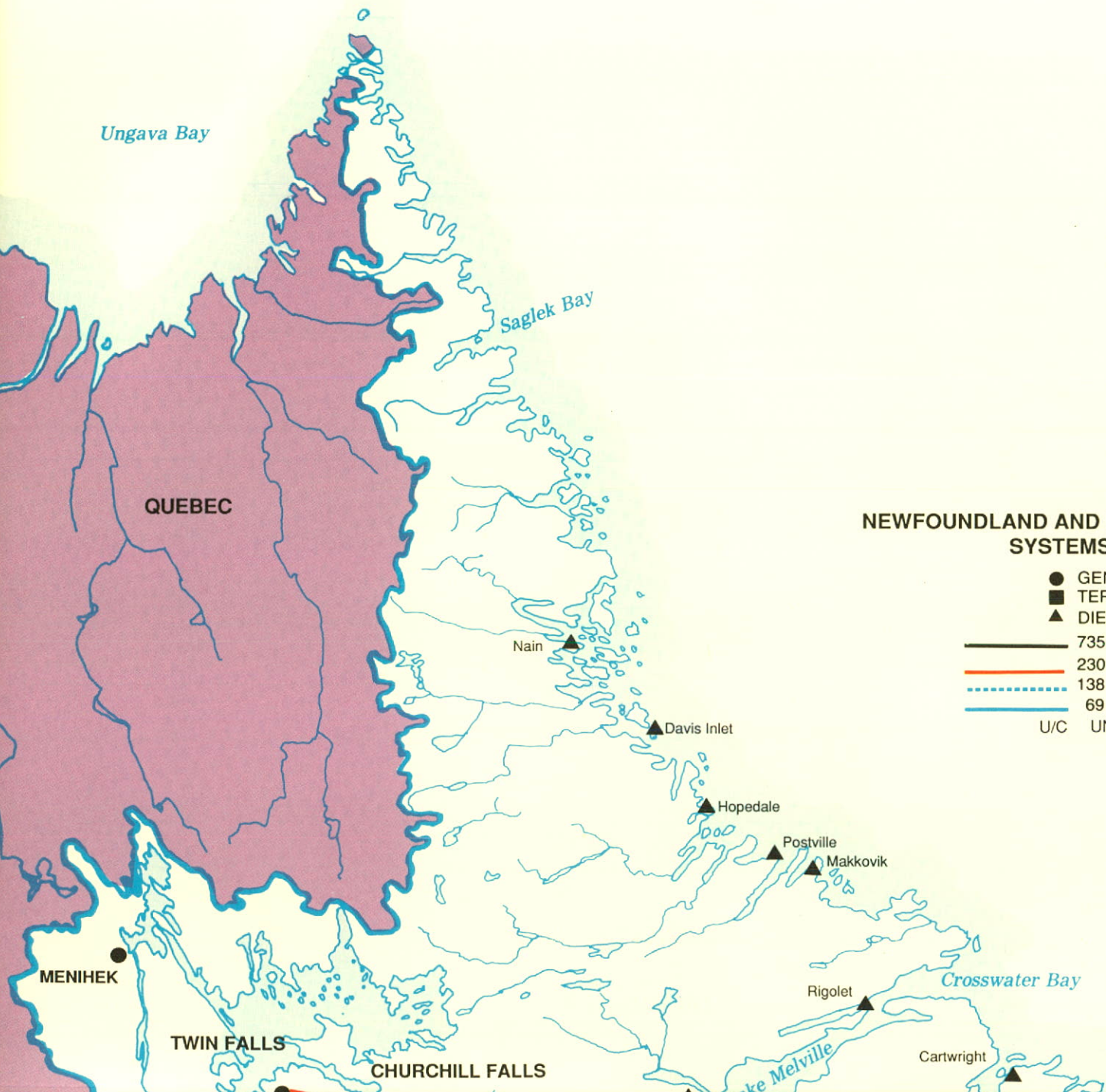
Power Distribution District of Newfoundland and Labrador

Cyril J. Abery, Chairman
T. David Collett, Vice-Chairman
Maureen P. Greene, Corporate Secretary
Peter A. Hickman, Assistant Corporate Secretary

Newfoundland and Labrador Hydro

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HYDRO SYSTEMS MAP UNDER FOLD.



NEWFOUNDLAND AND LABRADOR HYDRO SYSTEMS MAP

- GENERATION
- TERMINAL STATION
- ▲ DIESEL
- 735 KV
- 230 KV
- ⋯ 138 KV
- 69 KV
- U/C UNDER CONSTRUCTION

Ungava Bay

Saglek Bay

QUEBEC

Nain

Davis Inlet

Hopedale

Postville

Makkovik

Rigolet

Crosswater Bay

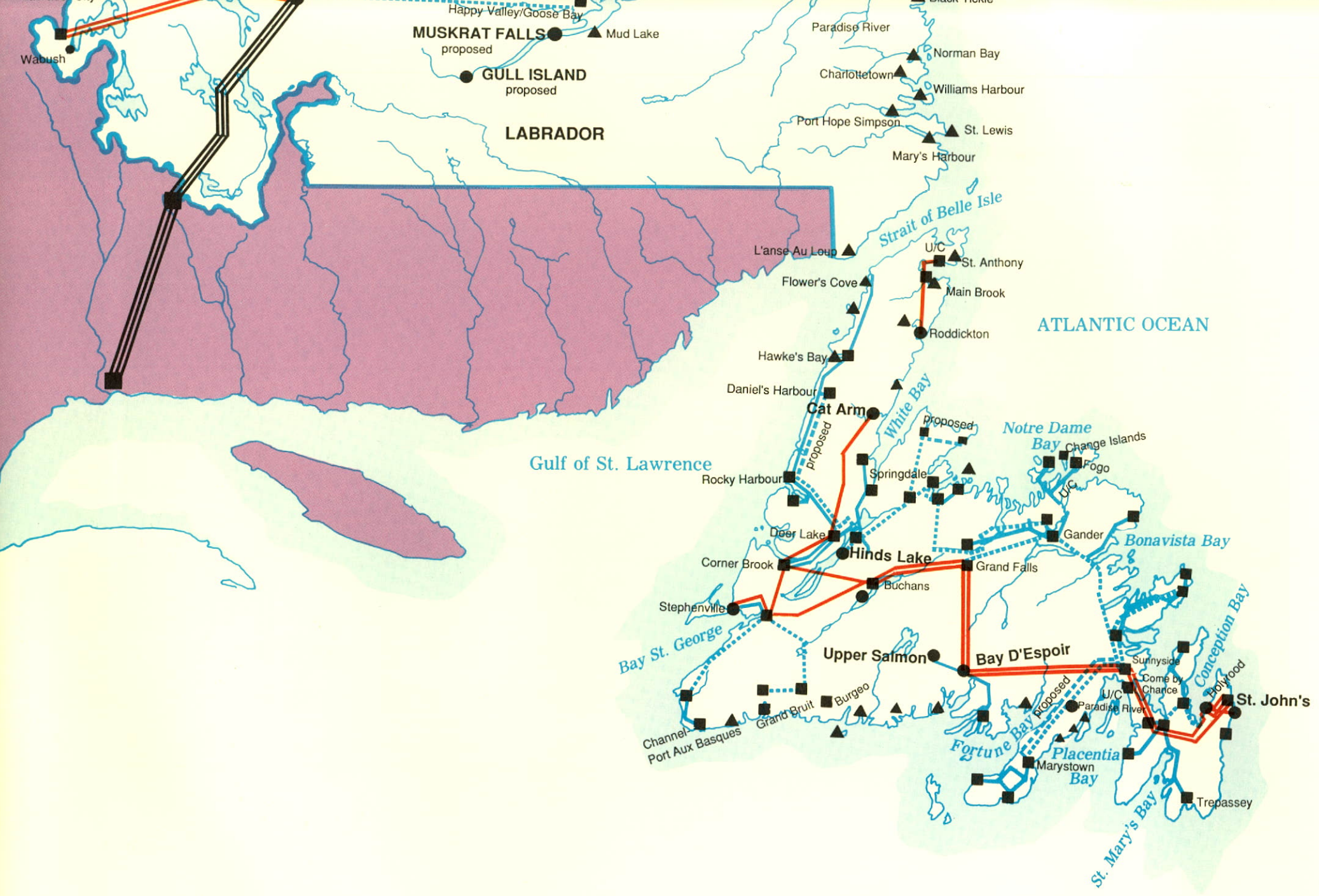
Lake Melville

Cartwright

MENIHEK

TWIN FALLS

CHURCHILL FALLS





NEWFOUNDLAND AND LABRADOR HYDRO