1997 Dominion Bond Rating Service (DBRS) Report

Newfoundland Light & Power Co. Limited

Current Report: January 30, 1997
Previous Report: January 8, 1996

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RATING

Rating	*Trend*	*Rating Action*	*Debt Rated*
A	Stable	Confirmed	First Mortgage Bonds
Pfd-2	Stable	Confirmed	First Preference Shares

RATING HISTORY (as at December 31)

	Current	1995	1994	1993	1992	1991	1990	1989
First Mortgage Bonds	A	A (high)	A (high)	A (high)	A (high)	A (high)	A (high)	A (high)
First Preference Shares	Pfd-2	Pfd-2	Pfd-2	Pfd-2	Pfd-2	-	-	-

RATING UPDATE

Earnings remain fairly stable with little growth expected in the rate base given the relatively poor provincial economic outlook over the near term. The Utility purchases most of its electricity needs from government owned Newfoundland and Labrador Hydro, whose power generation is largely low cost hydro based. Any increase in power demands would probably be financed with higher cost oil based generating facilities, however, the sluggish Newfoundland economy suggests that the issue is not currently a significant concern.

With a 45% deemed equity component, the balance sheet and coverage ratios remain favourable relative to other investor owned utilities. The Utility's other strengths include limited competitive pressures given the geographic isolation of the service area and unavailability of natural gas, while the lack of control over a major cost component (power purchases), and a competitive home heating market represent primary challenges.

RATING CONSIDERATIONS

Strengths:

- Permitted to pass on increases in power purchase costs.
- Geographic isolation and unavailability of natural gas limit competitive pressures.
- Relatively strong balance sheet, 45% deemed equity.
- Weather variance account reduces earnings variability.
- Low fixed costs as Utility purchases 91% of its power.

Challenges:

- Major cost component determined by a third party. Power purchases account for high unit variable costs.
- Earnings growth based on weak economic outlook.
- Revenues under some pressure in home heating market (54% of revenues).
- Rate increases may reduce competitive position relative to oil.

FINANCIAL INFORMATION

	12 Mos. ended	For years ended December 31						
	Sept 30/96	1995	1994	1993	1992	1991	1990	1989
Net Interest Coverage (bef cap int) (times)	2.90	2.79	3.03	3.07	3.05	2.89	2.87	2.68
% Allowed Common Equity	40-45	40-45	40-45	40-45	40-45	40-45	40-45	40-45
% Common Equity in Capital Structure	46.48	47.72	48.09	48.52	45.75	44.57	44.14	42.08
Cash Flow/Total Debt (times)	0.14	0.16	0.24	0.25	0.24	0.25	0.25	0.23
Revenue (cents per kWh)		7.65	7.65	7.68	8.00	7.74	7.21	6.89
Fixed Costs (cents per kWh)		1.48	1.62	1.59	1.49	1.45	1.42	1.24
Variable & Semi-Variable Costs (cents per kWh)		5.61	5.48	5.51	5.92	5.72	5.25	5.19
Net Margin (cents per kWh)		0.56	0.54	0.57	0.58	0.56	0.54	0.46
Reported Net Income ($ millions)	27.1	28.2	27.8	29.2	29.7	27.8	26.3	24.4
Allowed Return on Common Equity (%)	11.0	13.25	13.25	13.25	13.25	13.25	13.95	13.95
Return on Common Equity (%)	11.36	12.02	12.01	12.62	13.47	13.18	13.61	13.90

COMPANY

Newfoundland Light & Power Co. Limited (NLP) distributes electricity across the island of Newfoundland. The Utility purchases 91% of its electricity from government owned Newfoundland and Labrador Hydro, and generates the balance from owned facilities. NLP's revenue base consists of a 60% - 40% split between residential and commercial/light industrial accounts. Newfoundland Light & Power is a wholly owned subsidiary of Fortis Inc.

Rating Considerations

Strengths: (1) Newfoundland Light & Power (NLP) is permitted by the PUB to pass on any increase in power costs from Newfoundland and Labrador Hydro (N&L Hydro) to the consumer. (2) Geographic isolation of the service area and the unavailability of natural gas limits competitive pressures. Any gas discoveries in the area would obviously introduce competition to a relatively protected market. (3) NLP has one of the strongest balance sheets in the industry, and its parent (Fortis Inc.) could potentially provide financial support should the need arise. Debt maturities are well staggered with no repayments required until 2005. (4) The Utility is allowed to maintain a weather normalization account to adjust for variances in temperature and hydro-electric power availability against long term averages. Although the ultimate impact is small (less than 1.5% of revenues), it provides NLP with a mechanism to stabilize earnings. (5) As the Utility generates very little of its power requirements, fixed costs are very low. NLP, thus, has considerable flexibility in weathering a weak economic environment. (6) NLP's service area covers the more densely populated areas of the island, consisting of a 60%-40% split between residential and commercial/small industrial accounts. N&L Hydro services the more costly, and remote rural customers in addition to large industrial accounts.

Challenges: (1) NLP lacks control over a major component of its cost structure. The cost of purchased power, which accounts for 60% of NLP's total costs, is determined by N&L Hydro. Because the Utility purchases 91% of its power needs, variable unit costs are unusually high. (2) NLP's earnings outlook is based largely on the provincial economic outlook. Growth in kWh generated and sold over the last 6 years is amongst the lowest of all private Canadian utilities, and received a considerable boost from the Hibernia construction activity which peaked in 1995. Over the short term, completion of the construction phase of Hibernia, as well as public sector restraint, changes in the Employment Insurance program and emigration will all contribute to poor economic growth. Over the longer term, the provincial economic outlook is more positive, given the expected development of the Terra Nova and White Rose oil fields (and any other oil/gas discoveries), in addition to Voisey's Bay's smelting facility. (3) Revenues have been under some pressure during the past few years, as oil prices declined, in the space and water heating markets, (roughly 54% of total sales) where oil competitors engaged in an active marketing campaign to convert electricity users. In response, the Utility has had to initiate their own advertising campaign to counteract oil companies' claims of cost savings. New home penetration has stabilized at 75%, but the incident reflects the competitive pressures that are beginning to surface in the utility industry. Marketing efforts (and expenses) to maintain market share are expected to become a more critical activity in the future. (4) Power costs from N&L Hydro are based on a blended rate produced from a mix of roughly 75% hydro and 25% thermal generated power. While this mix would suggest that power costs are low (hydro sourced power is usually low cost), any growth in power demands will probably be met by oil based generating plant additions (by N&L Hydro), which would cause rates to rise. Rate increases, while not a cost consideration to NLP as it is permitted to pass on the increase, are a concern in terms of marketing, as any increase in electricity rates could reduce the competitive gap relative to oil in the home heating market. (5) In 1995 Revenue Canada issued a Notice of Reassessment disallowing certain deductions made by NLP for tax purposes. The Utility paid out one-half of the amount of taxes in dispute during 1995, but faces an additional potential liability of another $15.6 million, should their Notice of Objection be rejected by the government.

Regulation

NLP is regulated by the Board of Commissioners of Public Utilities for Newfoundland ("PUB"). The PUB recently reduced NLP's allowed rate of return on common equity to 11% (comparable to returns of other investor owned utilities) for 1996 and 1997 from 13.25%, and permitted a rate increase of 1% for 1997 effective January 1st, following the recent trend in interest rates. The Utility's deemed equity component of 45% (40-45% common, 3-6% preferred) was reduced marginally for 1997 (preferred 5-10%), but is still at the upper range of what other investor owned utilities are allowed. It is this capital structure which gives NLP one of the strongest balance sheets in the industry. The elimination of tax breaks for electric utilities (PUITTA) will have no impact on NLP, as the Utility was not originally subject to the legislation.

Earnings

Net earnings for the nine month period ended September 30, 1996 were down 4.4% compared to last year. The decline in earnings is the result of an unfavourable comparison to the prior period, when income taxes paid were abnormally low due to a tax deductible pension contribution. Discounting the pension adjustment, pretax earnings were up 11% on the strength of a 1.2% increase in revenues, largely attributable to the Hibernia project, and ongoing cost controls which led to a 0.9% decrease in operating expenses. These positive factors were partially offset by higher net interest expenses, as short term debt was replaced by a higher coupon $40 million bond issue. Growth in electricity demand over the near term is likely to be negatively impacted by the completion of the construction phase of the Hibernia project, as well as a poor provincial economic outlook. Little change is therefore expected in the level of earnings over the period.

Balance Sheet

The capital structure and balance sheet strength are determined by the allowed deemed equity of 45% (see Regulation). Special dividend payments are made from time to time (during 1996 and 1994) in order to maintain the common equity component within allowable limits. Operating cash flows have not been sufficient in recent years to finance these extraordinary dividends and the payment for disputed tax adjustments, and as a result, the % net debt in the capital structure has increased slightly to 51.5% from 48.1% in 1993. Coverage ratios, however, are relatively stable, and remain favourable compared to other investor owned utilities.

Newfoundland Light & Power Co. Ltd.

Balance Sheet

($ millions)	As at Sept. 30	As at December 31			As at Sept. 30	As at December 31	
Assets	1996	1995	1994	**Liabilities & Equity**	1996	1995	1994
Cash + equivalents	0.4	0.0	2.1	Bank borrowings	12.0	43.9	15.0
Accts receivable	39.6	38.9	36.3	Account payable	29.9	45.5	49.0
Materials + supplies	4.3	4.2	4.4	Other current liab	17.4	8.4	10.7
Prepaids	1.6	1.6	2.4	L.t.d. due in 1 year	2.6	2.2	9.3
Rate stab. acct	3.9	4.5	5.2	Current Liabilities	61.8	99.9	84.0
Current Assets	49.9	49.2	50.4	Long term debt	240.9	201.3	207.7
Def'd charges	26.1	14.3	13.2	Deferred credits	19.2	22.7	25.2
Corp. taxes	0.0	15.6	0.0	Preferred shares	9.9	9.9	10.9
Net fixed assets	486.4	489.4	489.4	Common equity	230.5	234.8	225.1
Total Assets	562.3	568.6	553.0	Total Liab & Equity	562.3	568.6	553.0

Ratio Analysis (1)	12 Mos. ended Sept. 30	For years ended December 31						
Liquidity Ratios	1996	1995	1994	1993	1992	1991	1990	1989
Current ratio	0.81	0.49	0.60	0.77	0.86	0.45	0.47	0.60
Asset coverage	1.94	1.99	2.02	2.04	2.02	2.05	2.06	2.02
Capital expenditures/Gross fixed assets	4.69%	3.84%	4.64%	4.57%	5.61%	6.20%	10.26%	9.62%
% Net debt in capital structure	51.49%	50.27%	49.35%	48.07%	48.62%	48.68%	48.59%	49.45%
Average interest cost of l-t debt		10.54%	10.67%	10.67%	10.67%	11.10%	11.08%	11.27%
Cash flow/Total debt	0.14	0.16	0.24	0.25	0.24	0.25	0.25	0.23
Capitalized interest/Net income	0.01	0.01	0.01	0.01	0.01	0.02	0.05	0.04
Capitalized interest/Net interest cost	0.01	0.01	0.01	0.02	0.02	0.03	0.07	0.06
Depreciation/Avg. gross fixed assets	3.29%	3.61%	3.62%	3.61%	3.60%	3.58%	3.66%	3.57%
Cash flow/Capital expenditures	0.93	1.29	1.53	1.69	1.37	1.26	0.76	0.76
Cash flow-divid/Capital expenditures	0.03	0.69	0.69	1.16	0.93	0.85	0.51	0.49
Common dividend payout	127.53%	65.13%	108.38%	59.15%	56.48%	60.24%	58.78%	59.36%
% Common equity in capital structure	46.48%	47.72%	48.09%	48.52%	45.75%	44.57%	44.14%	42.08%
% Allowed common equity	40-45%	40-45%	40-45%	40-45%	40-45%	40-45%	40-45%	40-45%
% Preferred equity in capital structure	1.99%	2.01%	2.33%	2.34%	4.79%	6.69%	7.27%	8.46%
% Allowed preferred equity	3-5%	5-10%	5-10%	5-10%	5-10%	5-10%	5-10%	5-10%
Coverage Ratios								
Gross interest coverage	2.74	2.60	2.86	2.86	2.82	2.70	2.65	2.49
Net interest coverage (bef cap int)	2.90	2.79	3.03	3.07	3.05	2.89	2.87	2.68
Net interest coverage	2.93	2.82	3.07	3.13	3.10	2.98	3.06	2.84
Fixed charges coverage (bef cap int)	2.68	2.56	2.77	2.64	2.52	2.34	2.29	2.08
EBITDA net interest coverage (bef cap int)	4.03	4.04	4.24	4.25	4.22	4.00	3.97	3.81
EBITDA fixed charge coverage (bef cap int)	3.70	3.68	3.86	3.63	3.46	3.22	3.14	2.92
Cash flow/net interest cost (bef cap int)	1.49	1.73	2.37	2.51	2.51	2.42	2.35	2.30
Earnings Quality								
Return on common equity (ROE)	11.36%	12.02%	12.01%	12.62%	13.47%	13.18%	13.61%	13.90%
Allowed ROE (common) - mid point	11.00%	13.25%	13.25%	13.25%	13.25%	13.25%	13.95%	13.95%
Achv'd ROE as % of allowed	103.31%	90.71%	90.64%	95.26%	101.63%	99.44%	97.53%	99.66%
Operating & admin. costs/Revenue	15.92%	16.19%	15.18%	15.04%	17.43%	17.06%	17.75%	17.45%
Power purchases/Revenue	56.07%	56.36%	55.65%	55.75%	55.56%	55.98%	53.95%	56.86%
Fuel costs/Revenue	0.02%	0.02%	0.01%	0.05%	0.02%	0.03%	0.07%	0.00%
Depreciation/Revenue	7.84%	8.53%	8.32%	8.07%	7.52%	7.47%	7.86%	7.57%
Gross operating margin	20.15%	18.91%	20.84%	21.09%	19.47%	19.46%	20.37%	18.12%
Net interest cost/Revenue	6.87%	6.71%	6.79%	6.74%	6.28%	6.54%	6.65%	6.38%
Gov't levies + taxes/Revenue	13.28%	12.20%	14.05%	14.34%	13.19%	12.92%	13.71%	11.75%
Net margin	7.94%	8.33%	8.22%	8.75%	8.62%	8.46%	8.59%	8.82%
Customers/Employee		260	255	248	210	205	195	196
Generation								
Generated		423	420	420	417	417	411	415
Purchased		4,186	4,178	4,093	4,066	4,008	4,008	3,772
Total energy generated + received		4,609	4,598	4,513	4,483	4,425	4,419	4,187
Internal use		14	15	15	16	15	13	12
Transmission losses		213	212	212	223	214	232	215
Total - millions of kWh		4,382	4,371	4,286	4,244	4,196	4,174	3,960
Energy loss/Energy gen + rec'd		4.62%	4.61%	4.70%	4.97%	4.84%	5.25%	5.13%
Energy sales growth		0.25%	1.98%	0.99%	1.14%	0.53%	5.40%	4.96%
Cost of power purchased - cents / kWh		4.56	4.51	4.54	4.70	4.59	4.12	4.17

(1) Ratios for quarterly periods calculated on a twelve month trailing basis.

Newfoundland Light & Power Co. Ltd.

Income Statements	9 Mos. ended Sept. 30		For years ended December 31						
($ millions)	1996	1995	1995	1994	1993	1992	1991	1990	1989
Revenues:									
Energy	255.3	252.1	335.3	334.2	329.0	339.4	324.6	301.1	272.8
Other	2.5	2.6	3.6	4.1	4.5	4.9	4.1	4.8	4.0
Total Revenues	257.8	254.7	338.9	338.4	333.6	344.3	328.7	305.9	276.8
Expenses:									
Operating + administration	40.2	40.7	54.9	51.4	50.2	60.0	56.1	54.3	48.3
Power purchases	138.9	138.1	191.0	188.3	186.0	191.3	184.0	165.0	157.4
Fuel costs	0.0	0.0	0.1	0.0	0.2	0.1	0.1	0.2	-
Depreciation	19.8	21.9	28.9	28.1	26.9	25.9	24.6	24.0	21.0
Total operating costs	199.0	200.7	274.8	267.8	263.2	277.3	264.7	243.6	226.6
Gross operating profit	58.8	54.0	64.1	70.5	70.3	67.0	64.0	62.3	50.2
Less: Interest expense	19.0	18.5	24.7	24.6	24.6	23.8	23.7	23.5	20.2
Capitalized interest	(0.1)	(0.1)	(0.3)	(0.3)	(0.4)	(0.4)	(0.7)	(1.4)	(1.0)
Interest income	(1.1)	(1.4)	(1.7)	(1.4)	(1.7)	(1.8)	(1.6)	(1.8)	(1.5)
Net interest expense	17.8	17.0	22.7	23.0	22.5	21.6	21.5	20.4	17.6
Pre-tax income	41.0	37.0	41.4	47.5	47.8	45.4	42.5	41.9	32.5
Income taxes	17.3	12.1	13.1	19.7	18.7	15.7	14.8	14.7	10.4
Earnings before transfers	23.7	24.8	28.2	27.8	29.2	29.7	27.7	27.2	22.1
Rate stabilization account	0.0	0.0	0.0	0.0	0.0	(0.0)	0.1	(1.0)	2.4
Reported net income	23.7	24.8	28.2	27.8	29.2	29.7	27.8	26.3	24.4
Operating Cash Flow	41.2	45.5	39.8	55.0	57.5	55.1	53.7	51.1	43.0
Less: Dividends	29.6	13.8	18.6	30.1	17.9	17.6	17.7	16.5	15.5
Capital expenditures	30.4	23.0	30.8	36.0	34.1	40.3	42.5	67.3	56.5
Cash flow before W.C.	(18.8)	8.8	(9.5)	(11.1)	5.5	(2.8)	(6.5)	(32.7)	(29.0)
Working capital	(10.6)	17.2	6.7	2.1	(7.6)	(6.1)	2.9	0.7	(1.8)
Free Cash Flow	(8.2)	(8.5)	(16.3)	(13.1)	13.2	3.3	(9.4)	(33.4)	(27.2)
Net Financing	8.6	7.0	14.4	4.4	(10.8)	5.6	11.5	34.4	27.6
Revenue Breakdown									
Residential			58.1%	58.0%	57.6%	56.8%	56.5%	56.6%	55.4%
General Service			40.8%	40.8%	41.0%	41.8%	42.2%	41.8%	46.2%
Non-energy			1.1%	1.2%	1.4%	1.4%	1.2%	1.6%	1.4%
Total - $ millions	257.8	254.7	338.9	338.4	333.6	344.3	328.7	305.9	276.8
Electricity Sold - Breakdown									
Residential			59.3%	59.3%	59.3%	59.1%	58.7%	57.6%	56.9%
General Service			40.7%	40.7%	40.7%	40.9%	41.3%	42.4%	43.1%
Total - millions of kWh	3,350	3,294	4,382	4,371	4,286	4,244	4,196	4,174	3,960
Unit Revenues and Costs	(cents/kWh sold)								
Revenues:									
Residential			7.57	7.57	7.56	7.79	7.54	7.20	6.80
General Service			7.76	7.77	7.84	8.29	8.00	7.22	7.50
Average Unit Revenue	7.62	7.65	7.65	7.65	7.68	8.00	7.74	7.21	6.89
Costs:									
Operating & Administration	1.20	1.23	1.25	1.17	1.17	1.41	1.34	1.30	1.22
Power Purchases	4.15	4.19	4.36	4.31	4.34	4.51	4.39	3.95	3.97
Fuel Costs	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00
Total Variable & Semi-Variable Costs	5.35	5.43	5.61	5.48	5.51	5.92	5.72	5.25	5.19
Gov't Levies/Taxes	0.52	0.37	0.30	0.45	0.44	0.37	0.35	0.35	0.26
Net Interest Costs	0.53	0.52	0.52	0.53	0.52	0.51	0.51	0.49	0.45
Total Cash Costs	6.39	6.31	6.43	6.46	6.47	6.80	6.59	6.09	5.90
Cash Margin	1.23	1.34	1.22	1.19	1.21	1.20	1.15	1.12	0.99
Depreciation	0.59	0.67	0.66	0.64	0.63	0.61	0.59	0.58	0.53
Net Margin	0.63	0.68	0.56	0.54	0.57	0.58	0.56	0.54	0.46
Total Operating Costs (deprec,var/semi-var)	5.94	6.09	6.27	6.13	6.14	6.53	6.31	5.84	5.72
Fixed Costs (deprec, interest + taxes)	1.64	1.55	1.48	1.62	1.59	1.49	1.45	1.42	1.24
Variable + Semi-variable Costs	5.35	5.43	5.61	5.48	5.51	5.92	5.72	5.25	5.19
Total Costs	6.99	6.98	7.09	7.11	7.10	7.41	7.17	6.68	6.43
Average Rate Increase	effective:		Jul 1st	Jul 1st	Jul 1st	Jul 1st	Jan 1st	Jul 1st	Jan 1st
Residential			1.0%	-0.7%	0.5%	0.3%	3.5%	0.8%	14.0%
General Service			*	*	*	*	*	*	*
Combined			1.0%	-0.7%	0.5%	0.3%	2.8%	0.8%	12.8%

* Various rates depending on kWh usage.