2001 Dominion Bond Rating Service (DBRS) Report

Newfoundland Power Inc.

Current Report: January 29, 2001
Previous Report: March 31, 2000

Rating

Rating	Trend	Rating Action	Debt Rated
"A"	Stable	Confirmed	First Mortgage Bonds
Pfd-2	Stable	Confirmed	Preferred Shares – Cumulative, Redeemable

Jenny Catalfo/Geneviève Lavallée
(416) 593-5577 x242/x277
e-mail: jcatalfo@dbrs.com

Rating History (as at Dec. 31)	Current	2000	1999	1998	1997	1996
First Mortgage Bonds	"A"	"A"	"A"	"A"	"A"	A (high)
Preferred Shares	Pfd-2	Pfd-2	Pfd-2	Pfd-2	Pfd-2	Pfd-2

Rating Update

DBRS is confirming the long-term debt rating of Newfoundland Power Inc. ("the Utility") at "A" and preferred share rating at Pfd-2, with Stable trends. The rating confirmations are based on the following considerations. (1) With a 45%-allowed deemed equity component, the Utility's key financial ratios remain among the strongest in the industry. Newfoundland Power has the highest allowed deemed equity of all Canadian regulated utilities, reflecting risk factors associated with its relatively small size and low growth business franchise. (2) Following cost control efforts and productivity initiatives (including early retirements) implemented during 1999-2000, profit margins have returned to historical highs. This is in spite of a significant decline in allowed ROEs over the last five years. The improvement in operating efficiencies has contributed to stronger operating cash flows. With ongoing capital expenditures in the $40 million range annually, the Utility should once again generate material cash flow surpluses that will be paid out in dividends. (3) The new return on rate base automatic adjustment formula, effective in 1999, has materially reduced, but not eliminated, the Utility's earnings sensitivity to interest rates. Together with the use of a weather normalization account, Newfoundland Power's earnings are, as a result, less volatile than some other regulated utilities. Nevertheless, an economic slow down in Canada, could potentially lead to a decline in interest rates, and allowed ROEs after 2001. The Utility's other long-term challenge relates to the possibility of industry restructuring in the province, which could result in the introduction of retail competition. Newfoundland Power is currently permitted to fully recover its power costs. Although its geographic isolation should minimize competitive pressures, retail competition, if introduced, could expose the Utility to commodity price risks.

Rating Considerations

Strengths:

- Regulation contributes to earnings/financial stability
- Weather normalization account reduces short-term earnings volatility
- Geographic isolation limits competitive pressures
- Key financial ratios comparatively strong; 45%-allowed deemed equity higher than other regulated utilities

Challenges:

- Sensitivity to interest rates (allowed ROEs)
- Potential industry restructuring could introduce retail competition in future
- Low electricity demand growth
- High coupon debt issues; early redemption uneconomic

Financial Information

	Industry Avg.*	12 mos.	For years ended December 31			
	Sep-00	Sep-00	1999	1998	1997	1996
Fixed Charges Coverage (times)	2.14	2.52	2.39	2.33	2.72	2.65
% Debt in Capital Structure	59.7%	54.7%	56.3%	56.8%	55.1%	54.5%
Cash Flow/Total Debt (times)	0.14	0.18	0.16	0.16	0.18	0.18
Cash Flow/Capital Expenditures (times)	1.21	1.29	1.19	1.09	1.73	1.84
Approved ROE	-	9.59%	9.25%	9.25%	11.00%	11.00%
Operating Income ($ millions)	-	72.1	67.9	63.5	72.3	68.4
Net Income ($ millions) (bef extras, after pfd div's)	-	28.4	23.4	21.6	28.1	25.1
Operating Cash Flows ($ millions) (after pfd div's)	-	54.3	50.4	48.5	49.8	49.3
Electricity Sold (GWh)	-	4,572	4,500	4,440	4,438	4,425

* DBRS Industry composite for Canadian gas and electricity distributors.

The Company

Newfoundland Power Inc. distributes electricity throughout the island of Newfoundland. The Utility purchases the bulk of its electricity needs from government owned Newfoundland and Labrador Hydro and generates the balance from owned facilities. Fortis Inc. (see separate report) owns all the common shares of Newfoundland Power Inc.

REGULATION

Newfoundland Power Inc. is regulated by the Newfoundland & Labrador Board of Commissioners of Public Utilities ("PUB") based on a cost of service/return on rate base methodology. In 1998, the PUB approved an automatic annual adjustment formula for adjusting the return on equity component of the return on rate base in response to changes in long-term Canada bond yields. The key difference between this mechanism and formulas used in other jurisdictions is that rather than fluctuating every year with the movement in interest rates, the approved return on rate base (and allowed ROE) is adjusted only if it falls outside a specified range. The automatic adjustment formula will be reviewed by 2003.

Due to the increase in long-term Canada bond yields, and based on the automatic adjustment formula, the rate of return on rate base for 2000 exceeded the specified range, and the allowed ROE was increased to 9.59% from 9.25% the previous year. The operation of the formula for 2001 indicated that the rate of return on rate base was within the approved range and therefore no adjustment was required. The allowed ROE remains at 9.59%.

The Utility's deemed equity component remains unchanged at 45%, the highest of all Canadian regulated utilities, reflecting risk factors associated with its relatively small size and low growth business franchise.

RATING CONSIDERATIONS

<u>Strengths</u>: (1) *Cost of service regulation contributes to relative earnings and financial stability.* The implementation of an automatic adjustment formula allows for periodic adjustments in the allowed returns and customer rates rather than annual adjustments. This reduces but does not eliminate the earnings sensitivity to interest rates. The automatic adjustment mechanism minimizes the related cost burden associated with regulatory reviews. In addition, Newfoundland Power is permitted by the PUB to pass on any increase in power costs from Newfoundland and Labrador Hydro to customers.

(2) *Weather normalization account reduces short-term earnings volatility.* The Utility is permitted to maintain a weather normalization account to adjust for variances in weather and water flows against long-term averages. This provides Newfoundland Power with a mechanism to stabilize earnings, particularly during periods of extreme weather conditions. Cash flows are unaffected by the normalization account and interest coverage ratios are artificially inflated over the short-term during periods of warmer than normal temperatures.

(3) *Relatively strong balance sheet.* The Utility has the highest allowed deemed equity component of all utilities in Canada, reflecting risk factors associated with its relatively small size and low growth business franchise. This contributes to relatively strong financial ratios compared to other regulated utilities.

(4) *Geographic isolation an effective barrier against external competitors.* The unavailability of natural gas also limits competitive pressures.

<u>Challenges</u>: (1) *Sensitivity to interest rates.* Approved ROEs have fallen between 1995-1999, consistent with the trend in long-term interest rates, negatively impacting interest coverage ratios over the period. This sensitivity to interest rates has been reduced by the automatic adjustment formula, but not eliminated (see Regulation). Note that this sensitivity increases along with growth in the rate base. An economic slowdown and/or recession in Canada could lead to a further decline in interest rates and allowed returns.

(2) *Restructuring of the electricity industry could introduce pricing pressures/exposure to commodity price risks.* Although it does not appear to be a priority, the Provincial Government initiated a review of the electricity industry in 1998 that could result in the introduction of retail competition in the future. The Utility currently flows through the cost of power to customers and therefore has no exposure to commodity price risk.

(3) *Low electricity demand growth.* Over the short-term, public sector restraint, the slow recovery of northern cod stocks, high unemployment and emigration will all contribute to relatively low demand growth for electricity. Over the longer term, the provincial economic outlook is more positive, given ongoing resource development and exploration in the region, including the Hibernia, Terra Nova and White Rose oil projects. Note that demand related to these projects is higher during the construction phase than during the operational phase of the projects.

(4) *Contingent $14 million tax liability.* The Canada Customs and Revenue reassessment in May 2000 significantly reduced the original liability from $40.3 million. The Utility continues to contest the revised tax reassessment with the government agency and may have recourse to the provincial regulator to recover the liability through future electricity rates.

(5) *High cost of debt.* The Utility has one of the highest weighted average coupons on outstanding long-term debt of all investor-owned utilities (9.66% versus 8.37% industry composite for gas and electricity distributors as at Dec-99). This high debt cost is not likely to change in the near future as there are no debt maturities prior to 2005, and early redemption remains uneconomic. The cost of debt is recovered in electricity rates, but contributes to a comparatively high cost of service.

EARNINGS

EBIT for the nine months ended September 2000 increased 7.8% to $57.9 million from $53.7 million for the same period last year. Roughly a third of the gain in EBIT is attributable to cost controls and productivity initiatives (including early retirements) implemented during 1999 and which continued into 2000, and the remainder to higher electricity sales and a 34 basis point increase in the approved ROE (to 9.59% from 9.25% the previous year).

Although some of the improvement was offset by a $2 million non-recurring charge (retirement allowances), net reported earnings for the 12 months ended September 2000 are well ahead of fiscal 1999, and profit margins have returned to historical highs. Net earnings for 2000 are expected to be similarly favourable in comparison to 1999 results.

Income Statements	12 Mos.	Nine months ended		For years ended December 31				
($ millions)	Sep-00	Sep-00	Sep-99	1999	1998	1997	1996	1995
Revenues:								
Residential	-	-	-	202.1	198.4	203.4	199.7	197.1
General Service	-	-	-	137.6	134.5	137.3	138.2	138.2
Gross electricity revenues	346.1	260.9	254.5	339.7	332.9	340.7	337.9	335.3
Power Purchases	196.7	143.5	139.5	192.7	191.5	190.6	192.1	191.1
Net electricity revenues	149.4	117.4	115.1	147.1	141.4	150.1	145.8	144.3
Other	2.6	1.7	1.4	2.3	2.9	3.0	3.6	3.6
Total revenues	152.0	119.1	116.5	149.3	144.3	153.1	149.4	147.9
Expenses:								
Fuel	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Operating + administration	48.9	37.0	39.9	51.7	52.6	53.9	54.6	54.8
Depreciation	30.9	24.2	22.9	29.6	28.1	26.8	26.3	28.9
Total operating costs	79.9	61.2	62.8	81.4	80.8	80.8	81.0	83.8
Operating income (EBIT)	72.1	57.9	53.7	67.9	63.5	72.3	68.4	64.1
Interest expense	27.9	21.2	21.0	27.7	26.6	25.8	25.2	24.3
Non-cash financial charges	(0.1)	(0.0)	(0.1)	(0.2)	(0.3)	0.0	0.1	0.1
Other (income)/expense	(1.2)	(1.0)	(0.9)	(1.1)	(1.0)	(0.9)	(1.2)	(1.7)
Net interest costs	26.7	20.1	19.9	26.5	25.2	24.9	24.0	22.7
Net income before taxes	45.4	37.8	33.8	41.4	38.2	47.4	44.4	41.4
Income taxes	16.4	13.7	14.7	17.4	16.0	18.7	18.6	13.1
Net income before extras.	29.1	24.0	19.0	24.1	22.2	28.7	25.8	28.2
LESS: Extraordinary items	2.6	2.0	0.0	0.6	0.0	3.1	0.0	0.0
Net income	26.5	22.0	19.0	23.5	22.2	25.6	25.8	28.2
Preferred dividends	0.6	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Net income available to common shldrs	25.8	21.6	18.6	22.9	21.6	24.9	25.1	27.6
Electricity Sold - Breakdown								
Residential	-	-	-	2,672	2,652	2,669	2,635	2,600
General Service	-	-	-	1,828	1,788	1,769	1,790	1,782
Total - GWh sold	4,572	3,445	3,373	4,500	4,440	4,438	4,425	4,382
Growth in volume throughputs		2.1%		1.4%	0.0%	0.3%	1.0%	0.3%

Outlook: The new formula implemented in 1999 reduces the earnings sensitivity to interest rates, but does not eliminate it. A slowdown in economic growth in Canada could potentially move interest rates out of the range specified under the new mechanism, reducing the approved ROE from the current 9.59% level. The adverse impact of a potentially lower ROE should, however, be partially offset by the relatively strong economic outlook for the province. The province's GDP outlook remains favourable (among the strongest of all provinces), with the Hibernia oil field continuing to ramp up production and a new field (Terra Nova) expected to begin production in mid 2001.

FINANCIAL PROFILE

Operating cash flows for the nine months ended September 2000 improved to $44.6 million along with earnings compared to the same period last year ($40.7 million), and the positive trend should be reflected in full year results. With annual capital expenditures expected to remain in the $40 million range for the next few years, including initiatives to improve system reliability, the Utility should once again begin to generate surplus free cash flows (excluding dividend payments). The cash flow/capital expenditure ratio is expected to be remain well above 1X, and surpluses will be paid out in dividends. The Utility has one of the strongest balance sheets in the industry, with the debt-to-capital ratio reflective of a 45% deemed equity component. As a result, cash flow/total debt and EBIT interest coverage ratios compare favourably relative to industry composites (fixed charges coverage - 2.52X and cash flow/total debt - 0.18X vs. industry composites of 2.13X and 0.14X respectively as at September 2000).

DBRS expects the Company will continue to manage balance sheet leverage to maintain debt ratios in the 55% range, and key financial ratios should remain among the strongest in the industry.

	12 mos.	Nine months ended		For years ended December 31				
	Sep-00	Sep-00	Sep-99	1999	1998	1997	1996	1995
Income (after pfd dividends)	25.8	21.6	18.6	22.9	21.6	24.9	25.1	27.6
Depreciation	30.9	24.2	22.9	29.6	28.1	26.8	26.3	28.9
Weather normalization account	n/a	n/a	n/a	(2.3)	(1.3)	(1.0)	(1.6)	0.1
Other non-cash adjustments	(2.5)	(1.1)	(0.7)	0.3	0.2	(0.9)	(0.6)	(1.9)
Operating Cash Flow	54.3	44.6	40.7	50.4	48.5	49.8	49.3	54.8
LESS: Capital expenditures (net of contrib.)	42.2	28.3	28.4	42.4	44.4	28.8	26.8	29.0
Cash before working capital changes	12.0	16.3	12.3	8.0	4.1	21.1	22.5	25.8
LESS: Working capital changes	(3.1)	(9.2)	(1.5)	4.6	(0.6)	1.6	(10.1)	6.7
Free Cash Flow before dividends	15.1	25.4	13.7	3.4	4.8	19.4	32.7	19.1
LESS: Common dividends	19.0	14.2	4.7	9.5	19.6	23.6	33.8	18.0
Free Cash Flow after dividends	(3.9)	11.2	9.0	(6.1)	(14.8)	(4.2)	(1.1)	1.1
LESS: Other investments	(1.7)	(3.2)	3.9	5.5	6.3	4.0	12.3	17.5
PLUS: Net debt financing (1)	5.9	(7.0)	(4.5)	8.5	16.3	(2.5)	37.3	15.3
PLUS: Net pfd financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.9)
PLUS: Net common equity financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Change in Cash Flows	3.8	7.4	0.6	(3.1)	(4.8)	(10.7)	24.0	(2.0)
Cash flow/Capital expenditures (times)	1.29	-	-	1.19	1.09	1.73	1.84	1.89
Cash flow/Total debt (times)	0.18	-	-	0.16	0.16	0.18	0.18	0.21
% Debt in the capital structure	54.7%	-	-	56.3%	56.8%	55.1%	54.5%	52.3%
Fixed charges coverage (times)	2.52	-	-	2.39	2.33	2.72	2.65	2.60

(1) Effective 1998, includes short-term financing. 1991-1995 includes short-term financing.

Operating Lines of Credit

$160 million of uncommitted bank operating lines of credit.

Debt Maturity Schedule

There are no debt maturities prior to 2005, although sinking fund requirements and installment payments amount to .050 million annually. In 2005, an 11.5%, First Mortgage Bond matures ($12.75 million) and in 2007 an 11.875% First Mortgage Bond matures ($31.47 million). The refinancing of these high coupon bonds should positively affect interest coverage ratios in the future.

Newfoundland Power Inc.

Balance Sheet
($ millions)

Assets:	Sep-00	1999	1998	Liabilities & Equity:	Sep-00	1999	1998
		As at December 31				As at December 31	
Cash + equivalents	3.8	0.0	0.0	S.T. debt	9.0	19.6	5.0
Accounts rec	22.8	33.1	33.0	A/P + accr'd liab	49.6	52.6	55.0
Materials + supplies	4.3	5.5	3.7	L.T.D. due in 1 year	3.1	3.1	3.1
Prepaids + stab acct	4.2	4.8	4.5	Current Liabilities	61.7	75.2	63.1
Current Assets	35.1	43.4	41.2	Def'd credits	10.4	12.2	15.0
Corp tax deposit	6.7	15.6	15.6	Long-term debt	280.2	280.2	283.2
Net fixed assets	523.3	519.7	507.4	Preferred shares	9.9	9.9	9.9
Deferred charges	47.1	41.7	36.5	Shlders' equity	250.2	242.8	229.5
Total	612.3	620.3	600.7	Total	612.3	620.3	600.7

Ratio Analysis	*Industry Avg**	12 Mos.	For years ended December 31					
Liquidity Ratios	*Sep-00*	Sep-00	1999	1998	1997	1996	1995	1994
Current Ratio	*0.90*	0.57	0.58	0.65	0.49	0.53	0.49	0.60
Accumulated depreciation/Gross fixed assets	*30.5%*	43.4%	42.3%	41.7%	41.6%	40.3%	38.9%	37.0%
Cash flow/Total debt (1)(2)	*0.14*	0.18	0.16	0.16	0.18	0.18	0.21	0.22
Cash flow/Capital expenditures (1)(3)	*1.21*	1.29	1.19	1.09	1.73	1.84	1.89	1.67
Cash flow-dividends/Capital expenditures (1)(3)	*0.48*	0.84	0.97	0.65	0.91	0.58	1.27	0.77
% Debt in capital structure (2)	*59.7%*	54.7%	56.3%	56.8%	55.1%	54.5%	52.3%	51.9%
Average coupon on long-term debt	*8.37%*	-	9.66%	9.66%	10.26%	10.26%	10.54%	10.67%
Deemed equity	-	45%	45%	45%	45%	45%	45%	45%
Common dividend payout (before extras.)	*97.9%*	66.8%	40.5%	90.9%	84.0%	134.3%	65.0%	108.4%
Coverage Ratios (4)								
EBIT interest coverage	*2.31*	2.62	2.49	2.43	2.84	2.77	2.71	2.98
EBITDA interest coverage	*3.24*	3.73	3.56	3.48	3.87	3.82	3.90	4.14
Fixed charges coverage	*2.14*	2.52	2.39	2.33	2.72	2.65	2.60	2.82
Earnings Quality/Operating Efficiency & Statistics								
Operating margin	*41.4%*	47.4%	45.5%	44.0%	47.2%	45.8%	43.3%	47.0%
Net margin (before extras, after pfd div's)	*16.8%*	18.7%	15.7%	15.0%	18.3%	16.8%	18.7%	18.1%
Return on avg equity (before extras.)	*10.9%*	11.5%	9.9%	9.4%	12.4%	10.9%	12.0%	12.0%
Allowed ROE (mid point) (5)	-	9.59%	9.25%	9.25%	11.00%	11.00%	13.25%	13.25%
Degree days - % Normal	-	-	85%	93%	103%	94%	101%	101%
GWh sold/Employee	-	-	6.5	6.3	6.3	5.5	5.3	5.4
Customers/Employee	*335*	-	307	301	299	260	251	254
Customers/Distribution lines	-	-	21	-	-	-	-	-
System efficiency (line losses)	-	-	5.1%	5.3%	4.9%	5.0%	4.9%	4.9%
Operating costs/Avg. customer ($)	-	-	385.1	385.3	388.7	393.8	412.1	396.9
Growth in customer base	*1.4%*	-	0.7%	0.7%	0.9%	1.0%	0.9%	1.6%
Rate base ($ millions)	-	-	506	488	477	473	470	465
- growth	-	-	3.7%	2.3%	0.8%	0.6%	1.1%	1.1%
Generating Capacity								
Installed capacity (Megawatts)		-	148	148	147	147	147	147
Generated		-	450	429	424	423	423	420
Purchased		-	4,292	4,259	4,244	4,236	4,186	4,178
Energy generated + purchased		-	4,742	4,688	4,668	4,659	4,609	4,598
LESS: Transmission losses + internal use		-	242	248	230	234	227	227
Total (GWh)		4,572	4,500	4,440	4,438	4,425	4,382	4,371
Energy sales growth		-	1.4%	0.0%	0.3%	1.0%	0.3%	2.0%
Peak demand (Megawatts)		-	1,025	1,063	996	1,123	1,031	1,098

* DBRS Industry composite for gas & electricity distributors. Value for average coupon, customers/employee and customer growth is as at December 1999.

(1) Cash flows are after preferred dividends.

(2) Preferred shares treated as a debt equivalent.

(3) Capital expenditures are net of customer contributions.

(4) Before capitalized interest, AFUDC, and debt amortizations.

(5) ROE is adjusted annually, but Newfoundland Power is regulated based on a return on rate base effective 1999. See Regulation section in report.