1998 Canadian Bond Rating Service (CBRS) Report

CBRS Credit Analysis

NEWFOUNDLAND POWER INC.

(FORMERLY NEWFOUNDLAND LIGHT & POWER CO. LTD.)

October 19, 1998

Volume II – Utilities & Electrical

	Current Ratings	Rating Outlook	Rating Status
First Mortgage Bonds	A(Low)	Stable	Revised
Preferred Shares	P-2	Stable	Revised

Filing Instructions: Replaces all previous reports.

RATING OPINION

CBRS' has revised the ratings on Newfoundland Power's First Mortgage Bonds and Preferred Shares to **A(Low)** and **P-2** from single A and P-2(High), respectively following completion of our annual review. The rating outlook remains **Stable**. At the same time, CBRS has assigned a rating of A(Low) to Newfoundland Power's proposed $50 million offering of First Mortgage Sinking Fund Bonds, Series AI. These securities will be direct secured obligations of Newfoundland Power and rank pari passu with all other series of First Mortgage Bonds.

Newfoundland Power's good quality ratings have generally been supported by its strong level of coverage ratios (margin of protection) required to mitigate the risks associated with the company's relatively small size (in relation to other single "A" rated utilities), high electric rates and an economically weak franchise area. Therefore, in revising the credit ratings, CBRS considered a number of factors and uncertainties which include, but are not limited to, the following:

- A projected decline in revenues, earnings and coverage ratios in 1998 has reduced the margin of protection traditionally provided to the bondholders. Moreover, the near-to-mid term outlook is for flat to little improvement in earnings and coverage ratios, while the future direction of the electric/energy industry (restructuring / deregulation / privatization) is uncertain, but will nonetheless, increase the industry's risk profile. The adoption of an automatic adjustment mechanism for setting annual rates of return on common equity in future years (1998-2001) is expected to yield Newfoundland Power a regulated ROE measuring below the industry average. Based on today's Long Canadas, the Company's allowed ROE for 1999 would decline below its currently allowed 9.25% ROE thereby deteriorating coverage ratios somewhat.
- The uncertainty over several upcoming regulatory issues, including a proposed 1.48% rate increase and the issue over $2 million in potential excess earnings achieved during the 1992-1993 period could further impact the level of coverage ratios.
- Over the mid-term, the outlook for growth in energy sales is flat to slow. This is attributable to the continued weakness in the Province's economy, which is characterized by a declining population base, high unemployment and troubled conditions in the fisheries and mining industries. A weak economic outlook combined with a lack of customer diversity and expansion opportunities will limit the Company's ability to grow its rate base and revenue sources relative to other single "A" rated utilities.
- An increase in the Company's cost structure primarily related to a heavy regulatory agenda and future tax liabilities could impact future earnings performance, while anticipated rate hikes from Newfoundland Hydro may impact the Company's future competitiveness.
- A proposed government review of the Province's energy policy, which will include a review of existing legislation and regulations, developments in other jurisdictions, existing electricity industry structure, pricing, electricity supply and electricity as a tool for economic development, adds a level of further uncertainty.

Key Ratios

	1997	1996	1995	1994
Interest Coverage	2.7x	2.7x	2.7x	2.9x
EBITDA Int. Coverage	3.7x	3.8x	3.8x	4.1x
Cash flow/Total Debt	18.6%	19.0%	22.3%	23.6%
Total Debt : Equity	53:47%	53:47%	50:50%	50:50%
Return on Equity	11.0%	10.9%	12.0%	12.0%

RATING OUTLOOK STABLE

The province of Newfoundland has been amongst the lowest rated provincial credits in Canada (currently rated BBB with a Negative rating outlook) while the outlook is for continued low growth over the intermediate term, thereby limiting the Company's rate base and revenue growth potential. The provincial economy's dependence on the natural resources and fisheries industries continues to hamper economic growth, while the completion of construction at Hibernia's Bull Arm site in 1997 and delays in the start-up of the Voisey's Bay Nickel project in Labrador will limit economic activity in the near term.

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Along with the continued weakness in the provincial economy, strong competition from oil and propane gas and improved energy efficiencies have resulted in slow sales growth in recent years. These factors combined with electricity rates that are already amongst the highest in the country, have forced Newfoundland Power to contain its consumer rates. As a result, notwithstanding minor annual adjustments for the Rate Stabilization Plan, basic electricity rates have remained relatively constant in recent years. Despite these challenges, Newfoundland Power has been able to maintain its financial performance due to its downsizing initiatives and strict control over operating expenses and capital expenditures in recent years.

Capital expenditures are budgeted to increase to $43 million in 1998 from $30 million in 1997. This increase is attributable to a $13 million investment in the construction of a 6.1Megawatt hydroelectric plant at Rose Blanche Brook on the southwest coast of Newfoundland. This plant will be completed in the fall of 1998 and will be the first generation facility constructed by the Company in 14 years. Capital spending is projected to decline to about $36 million in 1999 and remain at traditional levels over the intermediate term. Capital spending will primarily be used to maintain the existing electrical system and enhance its reliability. The Company maintains good cash flow generating capabilities, which combined with a modest capital spending program and no major refinancing requirements except for the terming out of some short-term debt should result in little external borrowing activity and little change to its capitalization ratios over the intermediate term. In addition, the Company has $220 million in operating and short-term money market lines of credit available for short term liquidity purposes. Also, the Company announced that it will suspend the payment of common dividends to its parent, Fortis, over the next several quarters, in order to replenish its common equity to its allowed regulated limit. The PUB ordered that, for the purpose of determining the regulated return, the average common equity couldn't exceed 45%.

Overall, the company's profitability and coverage ratios (est. 2.4X in 1998 from 2.7X in 1997) are projected to decline in 1998. This is primarily due to slow to flat growth in energy sales and lower electric rates – the outcome of the PUB decision to lower the Company's allowed ROE. Although, low sales growth and relatively flat earnings are expected to persist, strict control over operating expenses, moderate capital expenditure requirements combined with good cash flow should allow the Company to maintain a sound balance sheet and satisfactory level of coverage ratios required to maintain its present ratings.

Rating History

First Mortgage Bonds

Oct 1998 – present	A(Low)
1981 – Oct 1998	A
1972 – 1980	B++

Preferred Shares

Oct 1998 – present	P-2
Sep 1990 – Oct 1998	P-2(High)
1983 – 1990	P-2

Recent Performance

Net earnings for the six-month period ended June 30, 1998 declined 19% to $15.5 million over the corresponding period in 1997, due to a decline in electric rates and lower energy sales. On July 31, 1998, the PUB reduced the Company's ROE to 9.25% from 11%, which resulted in a 2% reduction in rates, retroactive to January 1, 1998. Energy sales for the year to date period were 2571.7 GWh compared to 2590.0 GWh in 1997. Contributing to the decline was the completion of

Preferred Shares (At Dec. 31, 1997)

SER	DESCRIPTION	DIVIDEND	FREQ	CRNCY	ISSUED	SHARE O/S	O/S$($MM)	TRADING	RATING
A	CUM. RED. VOT. 1ST PREF.	5.50%	Q	CDN	1956	179,225	1,792	MTL	P-2
B	CUM. RED. VOT. 1ST PREF.	5.25%	Q	CDN	1956	337,983	3,380	MTL	P-2
D	CUM. RED. VOT. 1ST PREF.	7.25%	Q	CDN	1973	229,765	2,298	CDN	P-2
G	CUM. RED. VOT. 1ST PREF.	7.60%	Q	CDN	1979	241,950	2,420	TO/MTL/V	P-2

Long Term Debt (At Dec. 31, 1997)

SER	TYPE	CUSIP	CPN	MATURITY	CRNCY	FREQ	DAY CNT	ISSUED	O/S($MM)	OPTION	LEAD	RATING
AB	FMB	6513508U7	11.500	01-Dec-2005	C$	S	ACT/ACT	1985	14.0	PP/CALL/SF	ML	A(Low)
AC	FMB	651350BC3	11.875	16-Dec-2007	C$	S	ACT/ACT	1987	35.5	CALL/SF	WG	A(Low)
AD	FMB	651350BD1	10.550	01-Aug-2014	C$	S	ACT/ACT	1989	35.4	CALL/SF	WG	A(Low)
AE	FMB	651350BE9	10.900	02-May-2016	C$	S	ACT/ACT	1991	37.6	CALL/SF	WG	A(Low)
AF	FMB	651350BF6	10.125	15-Jun-2022	C$	S	ACT/ACT	1992	38.0	CALL/SF	WG	A(Low)
AG	FMB	651350BG4	9.000	01-Oct-2020	C$	S	ACT/ACT	1992	38.8	CALL/SF	WG	A(Low)
AH	FMB	651350BH2	8.900	07-May-2026	C$	S	ACT/ACT	1996	39.6	CALL/SF	WG	A(Low)

Protective Covenants – First Mortgage Bonds

- Negative Pledge
- New Issue Test:

Earnings Test

No Additional Bonds shall be issued unless the Net Earnings of the Company for the Earnings Period selected by the Directors shall have been at least 2.0 times the maximum annual interest charge on all Bonds to be outstanding after the proposed issue of Additional Bonds.

Additional Property Test

Additional Bonds shall not be issued in an aggregate principal amount which shall exceed 60% of the Fair Value of Additional Property.

construction at Hibernia's Bull Arm site in 1997 as well as a decrease in average usage by residential customers. These declines have been partially offset by increased energy sales to other medium to large customers.

COMPETITION

The space and water heating markets continue to face competition from other energy sources, with the oil companies, in particular, attempting to convert people away from electricity. Currently, both low oil prices combined with traditionally high electricity rates in Newfoundland. have compelled Newfoundland Power to control costs and deliver reliable service while holding the line on consumer rates. Electric rates in Newfoundland are amongst the highest in Canada, and therefore. the company's principal objective is to minimize future power rate increases. Since 1991, the company had the second lowest increase in electrical rates in Canada, including annual adjustments on July 1st of each year reflecting the operation of the Rate Stabilization Plan. The average cost of electricity to customers is approximately 7.7 cents per kWh. Of this, 55% is attributable to the expense of purchased power from Newfoundland and Labrador Hydro and 15% is attributable to finance charges. The remaining 30% is related to the cost of operations within Newfoundland Power. Although the commodity cost of oil is currently cheaper than electricity for space and water heating, electricity still remains the preferred choice for most applications, due to the cheaper capital cost of an electric heating system. Newfoundland Power continues to capture over 70% of the new housing market, and currently services over 50% of the total heating market in the province.

POWER SUPPLY

The company purchases approximately 90% of its electric power supply from Newfoundland and Labrador Hydro and obtains the remainder from its own generating facilities. The Board of Commissioners of Public Utilities of Newfoundland (PUB) regulates the principal terms governing Hydro's supply of power to the Company.

REGULATORY MATTERS

Newfoundland Power is regulated by the Board of Commissioners of Public Utilities of Newfoundland with respect to its rates, capital expenditures, issuance of securities, terms of service and related matters. The Company operates under traditional rate of return regulation whereby rates to customers are based on the cost of providing service, including a reasonable return.

On July 31, 1998 the PUB issued an order arising from a regulatory hearing that addressed the Company's capital structure and allowed rate of return. The PUB determined that an appropriate rate of return on equity for 1998 was 9.25% (compared to 11% in 1997). The Company had proposed a rate of return of 10.375%. The order also established an automatic adjustment mechanism for setting annual rates of return on common equity in future years.

Operating Statistics

	1997	1996	1995	1994
Regulatory Data				
Avg. rate base ($MM)	477.4	473.1	469.7	465.3
Return on avg. rate base	10.71%	10.63%	10.94%	10.97%
Operating Statistics				
Sources of energy (in millions of kWh)				
Purchased	4,244	4,236	4,186	4,178
Generated	424	423	423	420
Total	4,668	4,659	4,609	4,598
Sales (in millions of kWh)				
Residential	2,669	2,635	2,600	2,594
Commercial and street lighting	1,769	1,790	1,782	1,777
Total	4,438	4,425	4,382	4,371
Customers (year-end)	212,359	210,161	207,780	205,716
Number of regular employees	705	803	822	807

The reduction in rate of return resulted in a reduction in customer rates of approximately 2% retroactive to January 1, 1998. The estimated decrease in Newfoundland Power revenue is approximately $7 million. These adjusted rates are interim rates and will be finalized following a further hearing in the fall of 1998.

CORPORATE PROFILE

Newfoundland Power, is the principal distributor of electricity in the Province of Newfoundland, providing service to more than 212,000 residential, commercial and industrial accounts. The Company serves 85% of the electrical consumers in the Province of Newfoundland and approximately three-quarters of all sales are to residential and small general service customers. The Company owns and operates 32 small generating plants (total installed capacity of about 141.2 MW) but approximately 90% of its energy requirement is purchased from Newfoundland and Labrador Hydro Corporation for distribution and resale. The Company owns and operates approximately 9,800 kilometres of transmission and distribution lines. Newfoundland Power is a wholly owned subsidiary of Fortis Inc. CBRS

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NEWFOUNDLAND POWER INC.

(CDN$ millions)

Abbreviated Financial Statements	1997	1996	1995	1994	1993	3 Year Trend
	Year ended December 31					
Revenues	$344.6	$342.8	$340.6	$339.8	$335.3	+0%
Cost of Goods Sold	190.7	192.1	191.1	188.4	186.1	+0%
EBITDA	96.3	96.0	94.7	100.1	99.0	-1%
EBIT	69.5	69.6	65.8	71.9	72.1	-1%
Interest expense	25.9	25.3	24.4	24.4	24.2	+2%
Net earnings before unusual items	25.6	25.8	28.2	27.8	29.2	-3%
Net earnings after unusual items	25.6	25.8	28.2	27.8	29.2	-3%
Current assets	44.5	42.1	49.2	50.4	54.1	-4%
less current liabilities	90.7	79.3	99.9	84.0	70.3	+3%
Net current assets	(46.3)	(37.2)	(50.7)	(33.7)	(16.2)	-11%
Fixed + other assets	537.1	531.4	519.3	502.6	495.0	+2%
Total net assets	490.8	494.2	468.7	469.0	478.9	+2%
less other liabilities	17.1	19.4	22.7	25.2	25.3	-12%
less long-term debt	236.3	238.8	201.3	207.7	216.6	+4%
Equity: share capital	80.2	80.2	80.2	81.2	79.9	-0%
retained earnings	157.2	155.8	164.5	154.8	157.0	+1%
Total assets	581.5	573.5	568.6	553.0	549.2	+2%
Cash flow from operations	50.2	49.7	55.1	54.8	57.1	-3%
Proceeds from LT debt	0.0	39.5	0.0	0.0	0.0	N/A
Proceeds from equity issues	0.0	0.0	0.0	1.3	1.8	-100%
Sales of investments/assets	0.0	0.0	0.0	0.0	0.0	N/A
Capital expenditure (net)	30.9	28.2	30.8	36.0	34.1	-5%
Investments/acquisitions	0.0	0.0	0.0	0.0	0.0	N/A
Repayment of debt	2.5	2.2	13.6	1.9	2.3	+10%
Dividends paid	24.2	34.4	18.6	30.1	17.9	-7%

Capitalization ($ - %)	1997	1996	1995	1994	1993	3 Year Avg.
Short term debt	33.1- 6%	22.4- 4%	46.0- 9%	24.4- 5%	12.3- 3%	33.9- 7
Long term debt	236.3- 47%	238.8- 48%	201.3- 41%	207.7- 44%	216.6- 46%	225.5- 45
Deferred taxes	0.1- 0%	1.7- 0%	3.1- 1%	5.7- 1%	7.1- 2%	1.6- 0
Minority interest	0.0- 0%	0.0- 0%	0.0- 0%	0.0- 0%	0.0- 0%	0.0- 0
Equity - Preferred	9.9- 2%	9.9- 2%	9.9- 2%	10.9- 2%	10.9- 2%	9.9- 2
- Common	227.5- 45%	226.2- 45%	234.8- 47%	225.1- 48%	226.1- 48%	229.5- 46
Total capitalization	506.9-100%	498.9-100%	495.1-100%	473.7-100%	473.0-100%	500.3- 100

Coverage & Liquidity Ratios	1997	1996	1995	1994	1993	3 Year Avg.
Net tangible assets	1.9x	1.9x	2.1x	2.1x	2.1x	2.0x
Total debt:equity	53:47%	53:47%	50:50%	50:50%	49:51%	52:48%
Total debt:EBITDA	2.8x	2.7x	2.6x	2.3x	2.3x	2.7x
Interest coverage	2.7x	2.7x	2.7x	2.9x	2.9x	2.7x
EBITDA interest coverage	3.7x	3.8x	3.8x	4.1x	4.0x	3.8x
Cashflow / total debt	18.6%	19.0%	22.3%	23.6%	24.9%	20.0%
Preferred dividend coverage	40.8x	41.2x	47.5x	39.0x	19.7x	43.1x
All fixed charges coverage	2.6x	2.6x	2.6x	2.8x	2.7x	2.6x
Current ratio	0.49-1	0.53-1	0.49-1	0.60-1	0.77-1	0.50-1

Profitability Ratios	1997	1996	1995	1994	1993	3 Year Avg.
Net margin	7.4%	7.5%	8.4%	8.3%	8.9%	7.8%
Asset turnover	0.6x	0.6x	0.6x	0.6x	0.6x	0.6x
EBIT % total assets	11.8%	11.9%	11.2%	12.8%	13.0%	11.6%
Return on average common equity	11.0%	10.9%	12.0%	12.0%	12.6%	11.3%