Boundless Energy

nalcor energy

2008 Business and Financial Report

Key Accomplishments at a Glance

SAFETY

- Safety Lead/Lag Ratio target met (the ratio of SWOP observations to incidents).
- 5791 safety related SWOPs reported – a 29% increase over 2007.
- Safety Culture Workshop delivered to nearly 40% of workforce, including 80% of field employees.
- Safety Credo rolled out across the company and embedded into the corporate Safety Culture Program.
- Internal Responsibility System jointly developed with both IBEW locals through the Corporate Safety Advisory Committee.

ENVIRONMENT

- ISO 14001 Environmental Management System certification maintained for Hydro and Churchill Falls.
- Purchased wind power from island's first commercial wind project.
- Continued reduction in emissions from the Holyrood Generating Station.
- Environmental Assessment for Labrador – Island Transmission Link and Environmental Impact Statement for lower Churchill generation filed in early 2009.
- takeCHARGE energy efficiency partnership with Newfoundland Power launched to help electricity consumers save energy and money.
- Commenced site construction of the Ramea Wind-Hydrogen-Diesel Energy project – one of the first projects in the world to integrate generation from wind, hydrogen and diesel in a remote, isolated electricity system.

BUSINESS EXCELLENCE

- Finalized negotiations for equity in the Hebron oil field (4.9%) and White Rose expansion (5%).
- New Dawn Agreement reached with Innu Nation addressing the Lower Churchill Impacts and Benefits Agreement.
- $1.2 billion, 20-year capital plan filed with the Public Utilities Board.
- Long-term maintenance plan completed for the Churchill Falls' Powerhouse.
- Concluded power sales and transmission agreements for recall power from Churchill Falls.
- Bull Arm Fabrication Site transferred to Nalcor Energy.
- Equity level in the capital structure increased to 44%.

PEOPLE

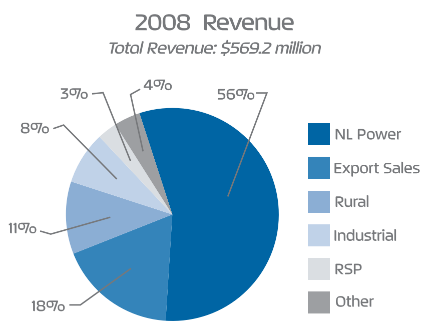
- Corporate vision and values renewal completed.
- Achieved a 79% response rate in the Employee Opinion Survey.
- Established Corporate Labour Management Team.
- New employee recognition programs implemented.

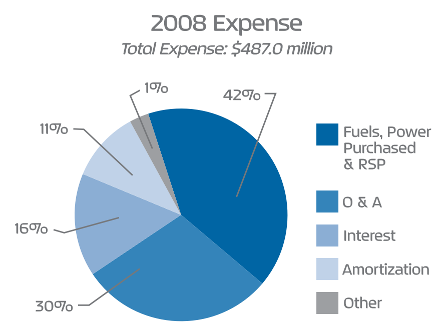
COMMUNITY

- Launched new name and corporate structure for the company – Nalcor Energy.
- Scholarship programs enhanced for Newfoundland and Labrador youth.
- Safety and Health partnership started with Seniors Resource Centre.

Financial Highlights

Years ended December 31 (millions of dollars)	**2008**	2007
Revenues	**569.2**	573.4
Net income	**82.2**	81.6
Capital assets, net	**1,862.8**	1,825.7
Long-term debt	**1,175.7**	1,187.8
Shareholder's equity	**934.5**	677.8
Dividends	**–**	–
Debt to capital	**56.0%**	65.0%
Return on capital employed	**8.9%**	9.9%





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

VALUES: At Nalcor Energy, our employees share a set of values that shape how we do business every day. Our core values set common direction on how to make decisions with a sense of pride and leadership. We recognize that it is not only what we achieve, but how we achieve it that truly makes us proud of our accomplishments. We believe our core values develop a culture based on high standards and expectations. We feel empowered to challenge the norms and seize new opportunities while working towards our corporate vision.

Nalcor Energy is a proud, diverse energy company, whose people are committed to building a bright future for Newfoundland and Labrador, unified by our core values.

Open Communication – Fostering an environment where information moves freely in a timely manner.

Accountability – Holding ourselves responsible for our actions and performance.

Safety – Relentless commitment to protecting ourselves, our colleagues, and our community.

Honesty and Trust – Being sincere in everything we say and do.

Teamwork – Sharing our ideas in an open and supportive manner to achieve excellence.

Respect and Dignity – Appreciating the individuality of others by our words and actions.

Leadership – Empowering individuals to help guide and inspire others.

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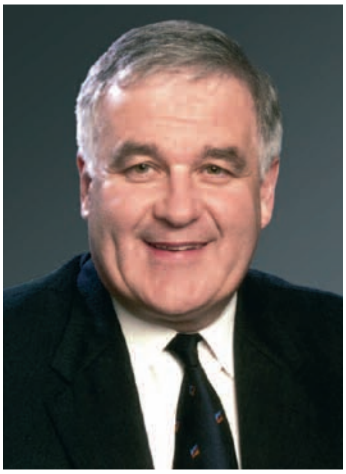
Message From the Chair



This past year was an exciting one for Nalcor Energy filled with opportunity and the enthusiasm and interest that come from positive change. Armed with a new vision and corporate structure, Nalcor Energy is poised to take its place as an energy leader for the people of Newfoundland and Labrador. It was a year of achievements in several key areas of our business reflecting our continued focus on consistent, long-term value for our Shareholder, the Government of Newfoundland and Labrador. I believe it also reflects the hard work and dedication of Nalcor Energy's employees.

In 2008, we continued to focus on safety, operational excellence and expanding our business to pursue new energy-related opportunities. We established Nalcor Energy as the parent company of our five lines of business: Newfoundland and Labrador Hydro, Churchill Falls, Oil and Gas, Lower Churchill Project and Bull Arm Fabrication. Our corporate structure includes dedicated leadership for all of our operating subsidiaries; and a new Board of Directors was appointed for Nalcor Energy – Oil and Gas.

The Nalcor Energy Board of Directors continues to focus on our business excellence and growth initiatives and these efforts are paying off – our base businesses are stable, and we have added new businesses that will position the company to become a driver for economic growth in Newfoundland and Labrador.

During the past year, the Board continued to implement a number of corporate governance changes resulting from the comprehensive governance review completed by the Board in 2007. Our commitment to strong corporate governance provides us with a solid foundation for our operations, which is critically important in the face of economic change. The next few years will be exciting for Nalcor Energy, but not without its challenges and risks; and the Board is committed to providing sound governance, direction, risk management and leadership.

Our success is made possible by the strong relationships we have forged throughout all aspects of our business. I thank all employees for their continued dedication to meeting the energy needs and expectations of all our customers. I also recognize the contribution of the members of the Boards of Directors for Nalcor Energy and thank them for their continued commitment and support.

Nalcor Energy is in a position to take advantage of additional energy opportunities we see on the horizon. The company, through strong leadership and employee commitment, is well positioned to meet this challenge.

John Ottenheimer
Chair, Board of Directors

Message From the CEO

This year is highlighted by a number of accomplishments, including the launch of our new name, Nalcor Energy, and a continued focus on safety, environment, business excellence, our people and our communities.

OUR SAFETY JOURNEY

World-class business performance is predicated on best-in-class safety performance. Nalcor has a comprehensive framework in place to achieve a world-class safety culture and a detailed roadmap to get there.

I believe we are on the right path. Our safety culture is taking hold and although some of our indicators reflect a setback, we had some tremendous gains in 2008. We met our lead/lag ratio target, which tells me our commitment to reporting remains strong. A majority of our front-line workers attended safety culture training and we also developed an Internal Responsibility System jointly with both International Brotherhood of Electrical Workers (IBEW) locals through our Corporate Safety Advisory Committee. However, we were challenged by an increase in the number of workplace incidents compared to the previous two years.

Nalcor aspires to have a safety culture where people do everything in their power to ensure that we achieve zero injuries. This is a long-term, relentless journey and sustained performance is the goal of this journey. Also instrumental to this success is the commitment of our employees and our partner in safety, the IBEW. Their continued support and leadership is essential.

BUILDING FOR THE FUTURE

Released in 2007, the province's Energy Plan lays out a strong vision for Newfoundland and Labrador, focused on maximizing the value of our provincial energy resources. This plan laid the foundation for the creation of Nalcor Energy and is our road map to 2041 and beyond.

Our foundation is built on the strength and expertise of our base businesses – Newfoundland and Labrador Hydro and Churchill Falls. We have a long history in the electricity business and are one of the largest hydroelectric developers and operators in North America.

It is this strength and expertise which will position Nalcor Energy for growth. In 2008, our Oil and Gas division became a partner in two developments offshore Newfoundland and Labrador – the Hebron oil field and the White Rose Growth Project. We continue to pursue other opportunities both onshore and offshore Newfoundland and Labrador.

The proposed development on the lower Churchill River is one of the best undeveloped hydroelectric resources in North America and significant steps were taken in 2008 to advance the Lower Churchill Project. One major achievement was signing the Tshash Petapen Agreement (New Dawn Agreement) between the province and Innu Nation. It is expected that this agreement, which addresses the Lower Churchill Impacts and Benefits Agreement, will be presented to the Labrador Innu for ratification in 2009.

In August, our Shareholder announced the transfer of the Bull Arm Fabrication Site to Nalcor Energy. This facility is an important asset for the development of the oil and gas industry in Newfoundland and Labrador, and the advancement of the province's fabrication capacity.

PURSUING OPPORTUNITIES IN NEW ENERGY

We are committed to investigating alternative energy sources to offset our existing non-renewable electricity supply and reducing reliance on thermal generation. Hydro has agreements to purchase energy from two wind development projects on the island and in 2008, purchased power from the province's first commercial wind farm, located in St. Lawrence.

Progress toward the integration of alternative energy sources continued in 2008 as the Ramea Wind-Hydrogen-Diesel Project began construction. This research and development project is building a viable commercial solution for deployment to other isolated diesel communities in the province, and potentially around the world.

OUR PEOPLE ARE AT THE CORE

Our people are at the heart of Nalcor Energy. We have a dedicated and talented team who share a common vision, core values and a relentless will to succeed. In 2008, we introduced a new vision and values to guide our employees on our journey.

We are dedicated to the development of our employees. Through management training and leadership programs, we are ensuring that our front-line supervisors and senior managers build their supervisory and leadership skills, knowledge and experience. In 2008, we also introduced new employee recognition programs to acknowledge the valuable contributions made by employees.

EXECUTING OUR LONG-TERM VISION

This company has a remarkable energy portfolio. Looking ahead, I see tremendous opportunities for Nalcor Energy. We have a sound strategy to deliver consistent and growing value to our Shareholder and the people of Newfoundland and Labrador. We face some challenges on the road ahead, but I am confident we will continue to make this a journey of success.

I thank the Board of Directors and our Shareholder, particularly the Department of Natural Resources, for their support of the company's new direction. I also thank all employees for their commitment and belief that we can do more for our province.

Ed Martin
President and CEO

Corporate Overview

Nalcor Energy's foundation is built on its base business: the generation and transmission of electrical power. Over the past three years, the company has expanded into the broader energy sector, including oil and gas, industrial fabrication, wind energy, and research and development. The company is also leading the

NEWFOUNDLAND AND LABRADOR HYDRO

Hydro is committed to operational excellence and for more than 50 years has been dedicated to delivering safe, reliable, least-cost power to industrial, utility and over 35,000 direct customers in rural Newfoundland and Labrador.

The company is the primary generator of electricity in Newfoundland and Labrador with an installed generating capacity of 1,635 megawatts (MW). In 2008, more than 80 per cent of this energy was clean, hydroelectric generation. Hydro's power generating assets include nine hydroelectric plants, one oil-fired plant, four gas turbines, 25 diesel plants, and thousands of kilometres of transmission and distribution lines.

CHURCHILL FALLS

The Churchill Falls Generating Station is one of the largest underground hydroelectric powerhouses in the world. The plant has 11 turbines with a rated capacity of 5,428 MW. In 2008, more than 34 terawatt hours (TWh) of clean electricity was produced, with the majority of that energy sold to Hydro-Québec through a long-term power purchase arrangement set to expire in 2041. Power is alsoused for mining operations in Labrador West and Hydro's Labrador Interconnected System.

Nalcor Energy – Churchill Falls, focuses on safety excellence, delivering reliable power to customers and ensuring future generations benefit from this world-class resource through long-term asset management.

OIL AND GAS

Nalcor Energy – Oil and Gas holds and manages oil and gas interests in the Newfoundland and Labrador offshore and is currently a partner in two developments – the Hebron oil field, the province's fourth offshore oil project, and the White Rose Growth Project.

development of the province's energy resources, including the lower Churchill hydroelectric development.

Nalcor Energy has five lines of business: Newfoundland and Labrador Hydro, Churchill Falls, Oil and Gas, Lower Churchill Project and Bull Arm Fabrication.

This line of business will continue to assess growth opportunities for the province's oil and gas resources.

LOWER CHURCHILL PROJECT

The Lower Churchill Project is the most attractive undeveloped hydroelectric project in North America. Its two installations at Gull Island and Muskrat Falls will have a combined capacity of over 3,000 MW and can provide 16.7 TWh of electricity per year. The projects could displace over 16 megatonnes of carbon dioxide emissions every year from thermal, coal and fossil fuel power generation – equivalent to the annual greenhouse gas emissions from 3.2 million automobiles.

This clean, stable, renewable energy provides the opportunity for Newfoundland and Labrador to meet its own domestic and industrial needs in an environmentally-sustainable way, with enough power remaining to export to other jurisdictions where the demand for clean energy continues to grow.

BULL ARM FABRICATION

Bull Arm is Atlantic Canada's largest industrial fabrication site. It has fully integrated and comprehensive infrastructure to support fabrication and assembly in three key project areas, simultaneously, in three separate theatres: Topsides Fabrication and Assembly; Drydock Fabrication and Construction; and the Deepwater Site.

This world-class facility has provided broader benefits to the province through new infrastructure, technical expertise, technology transfer and an experienced labour force. Bull Arm Fabrication is an important asset for Nalcor and the development of the oil and gas industry in Newfoundland and Labrador.

Safety

To be a safety leader.

Achieving excellence in safety is Nalcor's number one priority. To realize this goal, the company has established a safety framework built on leadership, procedures and equipment, competence, supportive culture, union/management alignment, responsibility and reporting. The company's continued focus and execution of its long-term safety plan will strengthen its safety culture to make world-class performance achievable and sustainable.

Safety is a shared core value at Nalcor. The company and its employees understand the importance of achieving a strong safety culture to attain sustained safety performance. In 2008, Nalcor implemented a number of safety strategies and initiatives aimed at changing behaviours and strengthening the company's safety culture. A two-day Safety Culture Workshop was delivered to nearly 40 per cent of the workforce, including 80 per cent of field employees. This workshop will continue in 2009 to ensure all employees participate. The company also established a new Safety Credo and embedded it into the corporate Safety Culture Program. The goal of the Safety Credo is to promote and foster personal responsibility for safety as a core employee value. In addition, an Internal Responsibility System (IRS) for safety was jointly developed with both IBEW locals through Nalcor's Corporate Safety Advisory Committee.

Another focus area for safety is contractor safety management and in 2009 the company will concentrate on ensuring its contractors share the same commitment to safety as Nalcor employees.

Nalcor Energy maintained its momentum for reporting incidents, near misses and safe practices through its Safe Workplace Observation Program (SWOP). Observations increased by 29 per cent over 2007. This demonstrates a clear commitment from employees to report and take action when they see unsafe conditions and behaviours. In addition, this strong commitment to reporting resulted in the company meeting its 2008 safety lead/lag ratio target of 250:1 (ratio of SWOP observations to incidents).

This past year was a challenging year with respect to safety incidents. Some business areas did well and others struggled. While Nalcor's lost-time, medical-aid and severity statistics were higher, the company made progress towards its safety goals on a number of fronts.

Safety will always be the company's number one goal and a driver for Nalcor's business success, and therefore it is critical to remain focused on the safety plan and committed to keeping everyone safe, every day.

Nalcor Energy's commitment to safety extends beyond its employees and customers, to the general public. In 2008, Hydro, a Nalcor Energy company, published the children's book "Why my Dad's job is so important", a concept first brought to Hydro by Delano Fowler, a retired Hydro Line Worker. The company believes everyone has a responsibility for their own safety and health, as well as the safety of others, and you are never too young to learn the importance of electrical safety. The inaugural reading of the book was done by Ingemar Dean, a Hydro Line Worker from Whitbourne.

Environment

To be an environmental leader.

Every year, Nalcor Energy invests in environmental protection measures to limit its ecological footprint. Mitigation measures are built into the company's development projects to reduce environmental impacts, and follow-up programs assess the effectiveness of these measures. ISO 14001 Certified Environmental Management Systems (EMS) govern the environmental activities in Nalcor's base businesses, Hydro and Churchill Falls. These systems include specific performance measures and a commitment to continual improvement.

A focus area for Hydro is the reduction of emissions from thermal generation. In 2006, Hydro switched from two per cent to one per cent sulphur fuel at the Holyrood plant resulting in a 50 per cent reduction in sulphur dioxide and particulate emission rates. In the spring of 2009, Hydro will switch to an even cleaner fuel with 0.7 per cent sulphur content, which will further reduce emissions from the Holyrood plant by 30 per cent.

In 2008, Nalcor Energy – Churchill Falls successfully completed 100 per cent of its EMS environmental targets and milestones. Environmental initiatives included converting the last of 11 underground transformers to environmentally-friendly transformer oil (Luminol), and the clean-up of five large sites of construction debris in the Twin Falls and Churchill Falls areas.

The company continues exploring opportunities to incorporate alternative sources of energy into the province's energy supply. Hydro currently has agreements to purchase energy produced by two 27 MW wind projects. In 2008, Hydro purchased wind power from the first commercial wind development in Newfoundland, located in St. Lawrence. Power from the Fermeuse wind site is expected by mid-2009.

Nalcor's Ramea Wind-Hydrogen-Diesel Project also began construction. This is one of the first projects in the world to integrate generation from wind, hydrogen and diesel in a remote, isolated electricity system. This research and development project has the potential to eventually replace diesel with zero-emission power and it has commercial prospects around the world.

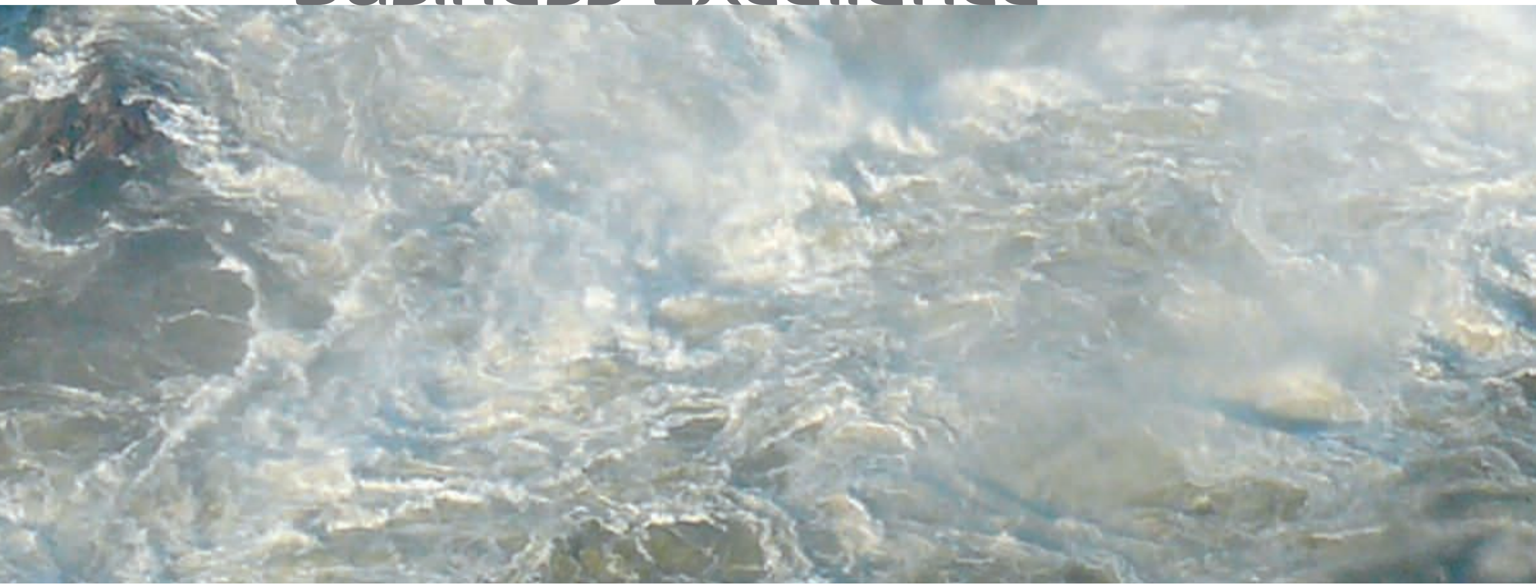
With funding from the Provincial Government, Hydro commenced two energy projects in select coastal Labrador communities in 2008 – an alternative energy study and an energy efficiency community pilot project. These two programs are important initiatives to identify technically-sound alternative energy options for coastal communities and meaningful ways for consumers to conserve energy.

Hydro is committed to helping consumers use energy wisely. In 2008, Hydro partnered with its largest customer, Newfoundland Power, and filed a five-year joint Energy Conservation Plan with the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB). This plan outlines program priorities for future energy conservation and efficiency opportunities in the province and has set a goal to save 70 gigawatt hours (GWh) of energy annually by 2013. Over the next five years, the two utilities will be increasing public awareness; providing education and information on energy efficient technologies; engaging communities and municipal leaders to include energy efficiency in their plans; and investing in promoting innovative technologies to help consumers reduce their electricity consumption.

Nalcor and its lines of business are also leading by example and have taken steps to reduce energy usage at its office buildings, generating stations and other facilities across the province. In 2008, these activities resulted in energy reductions of approximately 500 megawatt hours (MWh) of electricity. The company will expand its energy conservation initiatives to reduce energy at company buildings in 2009.

On November 13, 2008, Hydro and Newfoundland Power launched a new provincial energy efficiency partnership and brand, takeCHARGE – Saving Energy Starts Here! takeCHARGE provides Newfoundlanders and Labradorians with information, tools and programs to assist them in using energy wisely and encourages people to take charge and action in their own homes and businesses to reduce their energy usage. A new takeCHARGE website at takechargenl.ca was launched with tips, videos, rebate programs and contests that help electricity consumers save energy and money.

Business Excellence



Through operational excellence to provide exceptional value to all consumers of our energy.

Nalcor Energy's commitment to excellence transcends across its five lines of business. The foundation of the company is built on the strength and expertise of its base businesses – Hydro and Churchill Falls. Both companies are focused on long-term asset management to ensure a continued safe and reliable source of electricity. Renewed investment in the provincial electricity infrastructure is a priority for Hydro. In 2008, Hydro filed a $1.2 billion 20-year capital plan with the PUB that identifies the investments needed to upgrade aging infrastructure.

Churchill Falls focuses on operating, maintaining and investing in its assets to maximize long-term value. Key elements of its strategy include maintaining safety leadership, environmental stewardship and reliability. The company is taking steps to ensure the continued performance of the facilities so future generations benefit from this provincial resource.

In 2008, Nalcor Energy continued to expand its operations into the broader energy sector, making significant progress in the oil and gas industry. Nalcor Energy – Oil and Gas completed the acquisition of a 4.9 per cent working interest in the Hebron oil field; and also completed the acquisition of a five per cent working interest in the White Rose Growth Project in early 2009. The company continues its growth focus and is pursuing other investment opportunities.

The Lower Churchill Project team made significant progress last year in preparation for the submission of the Environmental Impact Statement of the lower Churchill generation project in Labrador as well as the initiation of the Environmental Assessment process for the Labrador-Island Transmission Link. A significant milestone was also reached in negotiations with the Innu Nation of

Labrador with the signing of the New Dawn Agreement. Step-by-step Nalcor Energy is obtaining the certainty needed to move forward with the project planning and further investment for the Lower Churchill Project.

In August, the Government announced the transfer of the Bull Arm Site Corporation to Nalcor Energy. Nalcor undertook a due diligence review of the site looking at environmental remediation, site maintenance and asset management. The company is also implementing a full review of the potential operational models for this world-class facility.

Nalcor assumed full operating control in 2008 of the Menihek Generating Station. In the previous year, the company assumed ownership of these assets from the Iron Ore Company of Canada and entered into a 40-year power purchase agreement with Hydro-Québec to supply electricity from this facility to Hydro-Québec for its customers in the Schefferville region.

The provincial government has licensed Nalcor Energy to manage and operate hydroelectric generation facilities in the central Newfoundland region on its behalf. These facilities were previously owned and operated by Abitibi Bowater.

Nalcor Energy will continue to strive for business excellence across the company with an approach to maximizing benefits from renewable and non-renewable energy resources to help build a stronger economy in Newfoundland and Labrador.

Nalcor Energy – Oil and Gas is currently a co-venturer in two offshore oil developments – the Hebron oil field and the White Rose Growth Project. Hebron, the province's fourth offshore oil project, is estimated to contain 400 to 700 million barrels of recoverable oil resources. The field was discovered in 1981, and is located offshore Newfoundland and Labrador in the Jeanne d'Arc Basin. First oil is expected before the end of 2017. The White Rose Growth Project, which includes the North Amethyst Field, West White Rose and the South White Rose Extension, is also located in the Jeanne d'Arc Basin. The North Amethyst Field is the first White Rose Growth Project area being developed. First oil from the North Amethyst Field is expected later 2009, early 2010.

People

To ensure a highly skilled and motivated team of employees who are committed to Nalcor Energy's success and future direction.

Nalcor's employees share a set of core values: honesty and trust, open communication, accountability, safety, teamwork, respect and dignity, and leadership. Throughout 2008, the company worked to integrate these core values in employee recognition programs, leadership development, performance management process, and recruitment and retention strategies and practices.

The company is focused on ensuring a workplace where people feel valued for their contributions. In 2008, Nalcor introduced a new Employee Recognition Program intended to foster an environment of shared recognition. The program contains three elements: renewed Service Awards, used to highlight milestones achieved by employees who have dedicated years of service to the company; and two new programs – the On the Spot Awards and the President's Awards. On the Spot Awards facilitate day-to-day recognition of employees by highlighting behaviours and actions supporting Nalcor's core values. The President's Awards are given to employees for significant accomplishments related to one of Nalcor's five corporate goals. Together, these three programs recognize the important contributions employees make to the company every day.

Another initiative was to focus on the development of employees and future leaders. Nalcor implemented a new Management Development program for senior managers with one third of the company's managers completing the program in 2008. Nalcor also continued its Leadership Fundamentals program, which provides both union and non-union front-line supervisors with important supervisory and performance skills. More than 200 employees have participated in this program since it was introduced in 2006.

Nalcor continues to pursue opportunities for collaboration on key initiatives with its union partner, the IBEW. In 2008, a Corporate Labour Management Team was established, comprised of members from Nalcor leadership and senior union leadership. This is a forum to discuss high-level issues across the company.

Measuring and managing the performance of employees is also important to help Nalcor achieve its long-term goals and vision. Nalcor's process was enhanced this year through improvements to online reporting tools. This performance management process for non-union employees provides a forum for ongoing dialogue between managers/supervisors and their employees, and is important to motivating individual performance, providing employees with feedback on their work, and appropriately recognizing and rewarding employees for their performance.

Nalcor uses employee participation in the Employee Opinion Survey (EOS) to give employees the opportunity to provide feedback about their work experience. Participation in the 2008 EOS survey was 79 per cent – significantly higher than the average EOS participation for companies in Atlantic Canada.

Nalcor held its inaugural President's Awards in November. These annual awards are presented to individuals who are role models and leaders in one of the five corporate goals and who have made outstanding contributions throughout the year.

The recipients of the 2008 President's Awards are (L-R): Jeff Vincent, People; John Flynn, Safety; Andy Mackay, Business Excellence; Marion Organ, Environment; Larry House, Business Excellence; Ed Arnott, People; and Bern Conway, Safety.

Community

To be a valued corporate citizen in Newfoundland and Labrador.

Nalcor Energy, through its subsidiary Hydro, manages its corporate citizenship activities through its Community Investment Program, which supports hundreds of programs, events and charities annually. The company takes pride in its commitment to strengthen the communities where it operates and its employees live and work. Significant investments in the focus areas of Safety and Health, and Environment and Conservation exemplify this commitment.

In 2008, Hydro started its safety and health partnership with the Seniors Resource Centre of Newfoundland and Labrador (SRC). This newly formed partnership will help the SRC expand and deliver their safety, health and wellness initiatives for seniors across the province. Hydro also supported the Single Parent's Association of Newfoundland and Labrador (SPAN). For over 20 years SPAN has provided support for single parents – delivering Crisis Intervention, Peer Support Group and Parent Effectiveness Training programs to single parents in the province.

Hydro also supports community initiatives that promote environmental awareness and preservation of Newfoundland and Labrador's unique environment. The company continued its 12-year partnership with the Conservation Corps of Newfoundland and Labrador by supporting three Green Teams in 2008 – Sheshatshiu, Flower's Cove and St. Alban's. Since 1996, Hydro has supported 15 Green Teams, employing 60 youth and contributing over $200,000 to support local environmental projects and youth employment opportunities throughout the province.

Nalcor Energy believes that supporting local communities goes beyond financial investments. Nalcor encourages volunteerism among its employees and supports

their commitment to local activities through its Employee Matching and Volunteer Contribution Programs. Through these initiatives, charities where employees donate their time and expertise receive a financial contribution from the company in the name of the employee. In 2008, more than 30 organizations were supported through these two employee-driven programs.

As a major employer in Newfoundland and Labrador, Nalcor recognizes the need to play a strong role in the development of the company's future workforce by collaborating with local educational institutions. In 2008, the company completed a strategic review of its Scholarship Program to enhance it for students and align it with the corporate goals. Throughout the year, more than $50,000 in scholarships and endowments were made by the company to students who are leaders and role models in their schools and communities. This includes the newly established Nalcor Energy endowment scholarship at Memorial University for Women in Engineering to help encourage and support women entering the engineering field.

Nalcor and its employees are committed to helping create healthy, vibrant communities throughout Newfoundland and Labrador. Hundreds of community groups across the province will continue to benefit from the company's community investments as it develops meaningful partnerships with charities through the gifts of time, expertise and financial support.

A priority area for Hydro's Community Investment Program is safety and health. The Seniors Resource Centre of Newfoundland and Labrador (SRC), selected as a safety and health partner in 2007, started its work in 2008 through various initiatives. Working with a network of Peer Advocate Groups, the SRC held a number of Safety and Health Days for seniors in different areas of the province. These events provide participants with information on falls prevention, first aid training, fraud prevention and elder abuse – to name a few. The SRC will continue to deliver Safety and Health Days throughout 2009.

Management's Discussion & Analysis

The following discussion and analysis is the responsibility of management and is as of March 31, 2009. Nalcor Energy maintains appropriate systems of internal control, policies, and procedures that provide management with reasonable assurance that assets are safeguarded and that its financial information is reliable. The Board of Directors carries out its responsibility for review of this disclosure principally through its Audit Committee, comprised exclusively of independent directors. The Audit Committee has reviewed and approved this Management's Discussion and Analysis (MD&A). This MD&A should be read in conjunction with the Consolidated Financial Statements of the company for the years ended and included in this Business and Financial Report, as well as the notes, for the respective years.

SECTION 1: CORE BUSINESSES, MARKETS AND STRATEGY

Nalcor Energy's legal structure at December 31, 2008, included two wholly-owned subsidiaries, Newfoundland and Labrador Hydro (Hydro) and Nalcor Energy – Oil and Gas Inc. (Oil and Gas). Hydro also held investments in three entities: 65.8% of Churchill Falls (Labrador) Corporation (Churchill Falls); 51% of Lower Churchill Development Corporation (LCDC); and 100% of Gull Island Power Corporation (GIPCo).

Nalcor Energy's vision is to build a strong economic future for successive generations of Newfoundlanders and Labradorians. The foundation is built on its base business – the generation, transmission and distribution of electrical power. The combined installed generating capacity of the company and its subsidiaries, 7,307 megawatts (MW), makes it the fourth largest power utility in Canada. Nalcor Energy's base business is providing safe, reliable and least-cost power to utility, industrial and retail customers. Beyond its base business, the company has expanded into the broader energy sector, including oil and gas, wind energy, industrial fabrication and research and development. Nalcor is also leading the development of the province's energy resources, including the lower Churchill hydroelectric development.

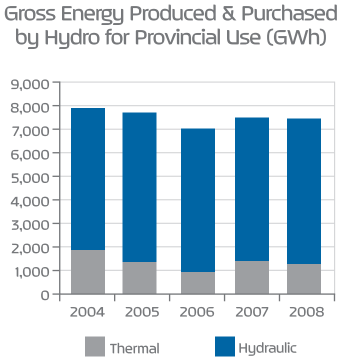
Newfoundland and Labrador has an immense and diverse energy warehouse. In 2007, guided by a long-term Energy Plan to manage these energy resources, the Government of Newfoundland and Labrador (Government or Shareholder) created a new provincial energy corporation. In December 2008, the energy corporation announced a new name; Nalcor Energy (Nalcor), brand identity and corporate structure with five lines of business: Newfoundland and Labrador Hydro, Churchill Falls, Oil and Gas, Lower Churchill Project and Bull Arm Fabrication.

In addition to these five lines of businesses, Nalcor also conducts activities in the energy sector which are managed corporately.

HYDRO

The activities of Hydro include the operation of the regulated utility and non-regulated activities. Non-regulated activity is discussed in this MD&A under Other Energy Activities. Hydro, the regulated utility, generates, transmits and distributes electrical power and energy to utility, industrial, commercial, and residential customers throughout Newfoundland and Labrador. Hydro's operations consist of sales of electricity to three primary customer groups:

- Newfoundland Power, an investor-owned utility that distributes electrical power to 236,000 customers on the island portion of the province, with Hydro supplying 92% of their energy requirements [(comprising 77.5% of regulated revenue (2007 – 77.1%)].
- Over 35,000 residential and commercial customers in rural Newfoundland and Labrador [comprising 14.4% of regulated revenue (2007 – 14.1%)].
- Major industrial customers in the pulp and paper, mining and oil refining industries [comprising 7.6% of regulated revenue (2007 – 8.3%)].



Hydro's generating assets, with a total capacity of 1,635 MW, consist of nine hydroelectric plants (939 MW), one oil-fired plant (490 MW), four gas turbines (150 MW) and 25 diesel plants (56 MW). In addition, Hydro has entered into a number of power purchase agreements with non-utility generators to supplement its own generation capacity. Hydro's business strategy is to strengthen and ensure the integrity of its core business of power generation, transmission and distribution. Hydro's goal of business excellence focuses on delivering value to its customers and Hydro executes its strategy with an uncompromising commitment to safety, environmental stewardship, operational excellence, its people and the communities where it operates.

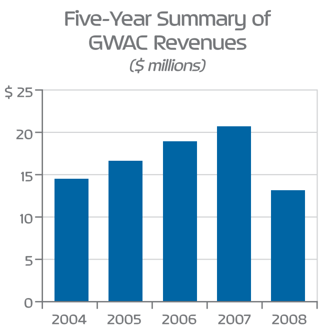
Hydro's focus is on both short and long-term supply issues. Decisions that address immediate concerns, and long-term requirements, help ensure there is adequate supply to meet the needs of existing customers and the future needs of residents, businesses and industry. Hydro remains committed to reducing its reliance on non-renewable generation sources and the promotion and implementation of energy efficiency and conservation programs, which are intended to help electricity consumers better manage and use electricity.

Hydro is the primary generator and transmitter of electricity for use in the province. It plays a role in ensuring there is a safe, reliable and cost-effective electricity supply available to meet current demand and future growth. Hydro is incorporating alternate sources of energy into the province's electricity supply by entering into two power purchase contracts with third parties to purchase energy from two 27 MW wind developments in St. Lawrence and Fermeuse.

With Hydro's generation, transmission and distribution assets aging, a key strategy is to invest in asset upgrading and replacements in concert with the development of a comprehensive asset management strategy. This strategy supports Hydro's approach of managing its assets in a manner that optimizes total cost of ownership, operation and maintenance while delivering safe, reliable service.

CHURCHILL FALLS

The Churchill Falls Generating Station is one of the largest underground powerhouses in the world with a rated capacity of 5,428 MW. A power contract with Hydro-Québec dated May 12, 1969, provides for the sale of almost 90% of the energy from this facility (approximately 30 terawatt hours) until 2041. Hydro owns 65.8% of Churchill Falls and purchases 300 MW, the maximum provided for under the power contract. Churchill Falls also sells 225 MW [approximately 1,800 gigawatt hours (GWh)] to Twin Falls Power Corporation (Twin Falls) to service the mining industry in Labrador West. In addition, Churchill Falls earns revenues from Hydro-Québec under a Guaranteed Winter Availability Contract (GWAC). The GWAC was signed with Hydro-Québec in 1998 and provides for the sale of additional capacity to Hydro-Québec during the months of November through March until the end of the power contract in 2041.



Management's Discussion & Analysis

The strategy for Churchill Falls focuses on operating, maintaining and investing in its assets to maximize long-term value while meeting all contractual obligations. Key elements of the strategy are: maintaining safety leadership, environmental stewardship and reliability. The company is taking steps to ensure the continued performance of the facilities through long-term asset management processes and strategic investment.

LOWER CHURCHILL PROJECT

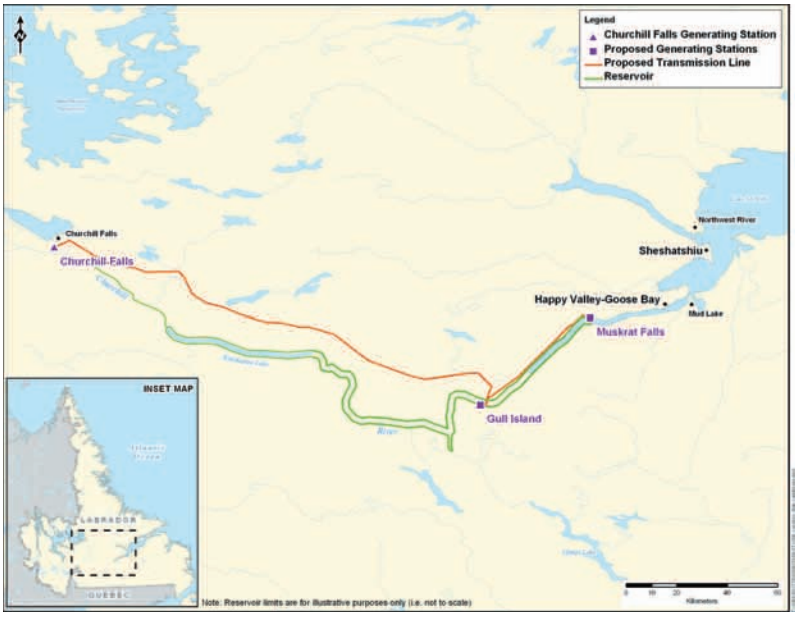
The lower Churchill River hydroelectric resource is one of the key elements in the province's energy warehouse. The potential of the lower Churchill resource, one of the best undeveloped hydro resources in North America, is immense. Together, Gull Island (2,250 MW) and Muskrat Falls (824 MW) will allow Newfoundland and Labrador to meet its own domestic and industrial needs in an environmentally-sustainable way, with enough power remaining to export to other jurisdictions where the demand for clean energy continues to grow.

The overarching execution process used by the Lower Churchill Project (LCP) team is called the Gateway Process. A gateway is at the end of each project phase and readiness checkpoints occur throughout. The Gateway Process provides a logical roadmap that ensures organized project planning and execution.

There are five gates within the LCP life cycle that mark important junctures of the project. The LCP is currently in Phase two, approaching Decision Gate Two which is essentially concept selection. The goal is to determine the best options and alternatives to achieve the business opportunity and pursue the project. Concept selection includes defining the project scope, front-end engineering and assessing the optimal return on investment (ROI). The LCP is currently undertaking aboriginal negotiations, environmental assessments, preliminary field work, market assessment and economic analysis to support Phase two.

OIL AND GAS

In 2008, a new company, Nalcor Energy – Oil and Gas Inc. was formed and it holds and manages oil and gas interests. The company is currently a partner in two developments in the Newfoundland and Labrador offshore oil and gas industry – the Hebron oil field, the province's fourth offshore oil project, and the White Rose Growth Project.



In 2008, significant progress was made by completing the acquisition of a 4.9% working interest in the Hebron oil field and hiring key personnel to manage the oil and gas activities and future opportunities in the energy sector. In addition, the company completed the acquisition of a 5.0% working interest in the White Rose Growth Project in January 2009. Nalcor Energy – Oil and Gas is also pursuing other investment opportunities.

BULL ARM FABRICATION

Bull Arm is a valuable asset for the province in the development of the oil and gas industry in Newfoundland and Labrador and the advancement of the province's fabrication capacity.

The Bull Arm facility was constructed by the Hibernia Management and Development Company (HMDC) in 1990 for the Hibernia project. In 1998, HMDC transferred ownership of the site to the province and the Bull Arm Site Corporation was formed. Since that time, fabrication and other work associated with the Terra Nova Floating Production, Storage and Offloading vessel, the White Rose project, the Voisey's Bay nickel project and the Henry Goodrich drill rig has been completed at the site.

This world-class facility is located close to the communities of Sunnyside, Arnold's Cove and Come By Chance and has provided employment and economic spin-off benefits through the purchase of goods and services to this area.

In August 2008, the Government announced the transfer of the Bull Arm Site Corporation to Nalcor Energy. Since that time, due diligence activities have been underway and the transfer was completed on March 31, 2009. The transfer of the site to Nalcor Energy will ensure this key asset is utilized to maximize the benefits to the province from the number of large-scale construction and fabrication projects on the horizon.

OTHER ENERGY ACTIVITIES

Other Energy Activities include the non-regulated activity in electricity generation in Hydro and other business opportunities in the energy sector, including: wind generation, alternative energy, and research and development. On March 31, 2009, the company's five-year power sale agreement to sell energy to Hydro-Québec expired. Hydro signed a Transmission Service Agreement with Hydro-Québec under its Open Access Transmission Tariff for power transmission from the Labrador to the Canada-U.S. border. Hydro is then selling power on the Canadian side of the border to Emera Energy Inc. Emera Energy began selling that power to the energy markets in Canada and the United States on April 1, 2009. The revenue and earnings in this segment are derived from electricity sales to Hydro-Québec, from the 300 MW power sales agreement (Recall Power), and from sales to two industrial customers in Labrador.

In 2007, Hydro assumed ownership of the Menihek Generating Station from the Iron Ore Company of Canada (IOC) and entered into a 40-year power purchase agreement to supply electricity from this facility to Hydro-Québec for its customers in the Schefferville region.

Nalcor also continues its assessment of development opportunities of large-scale wind in Labrador. In the area of research and development, Nalcor Energy's main strategic focus continues to be on the successful development of the Ramea Wind-Hydrogen-Diesel project. This project provides the potential for alternate renewable energy in isolated systems currently served with diesel generation.

Management's Discussion & Analysis

SECTION 2: PERFORMANCE

FINANCIAL OVERVIEW

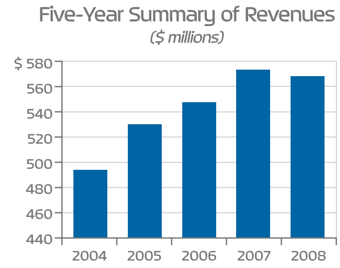
This section provides an overview of Nalcor Energy's financial performance based on its audited Consolidated Financial Statements.

millions of dollars	2008	2007
Revenue	$ 569.2	$ 573.4
Expenses	487.0	491.8
Net Income	$ 82.2	$ 81.6
Key Financial Performance Indicators:		
Return on Equity	10.0%	13.0%
Return on Capital Employed	8.9%	9.9%

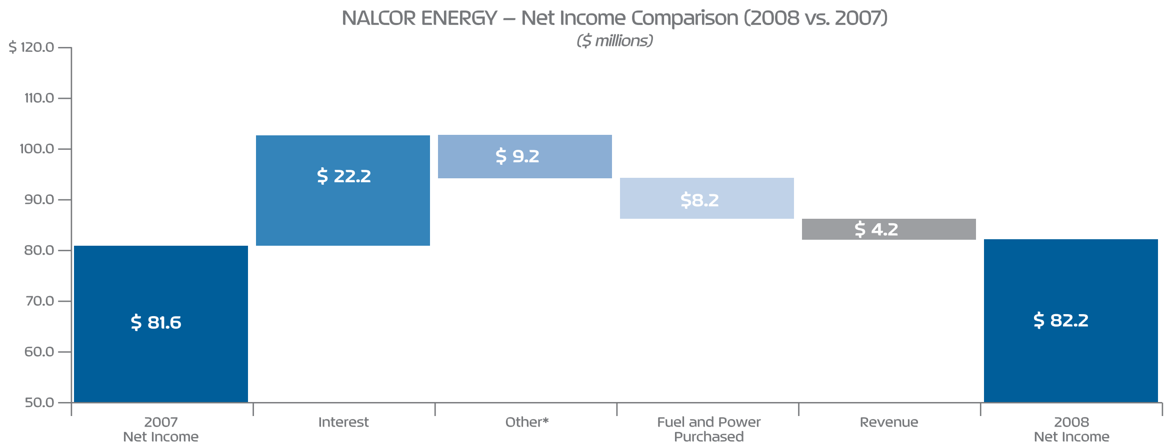
Description of Performance Indicators
Return on Equity (ROE) *– Net Income/Average Equity.*
Return on Capital Employed (ROCE) *– Net Income plus Interest/Average Debt plus Equity (adjusted for assets under development).*

Overall net income for 2008 was $82.2 million, a slight increase over the $81.6 million reported for 2007. While the overall level of net income did not change significantly, there were a number of significant items that had both positive and negative impacts on net income. These are outlined below and discussed in more detail in the business segment review.

- Revenue was $569.2 million, a decrease of $4.2 million in 2008 compared to 2007, primarily due to a reduction in GWAC revenue in Churchill Falls related to a cable fire late in 2008. Additional details on the cable fire are included in the Churchill Falls segment discussion.



- Interest was $78.2 million, a reduction of $22.2 million compared to $100.4 million in 2007. This reduction is primarily the impact of the waiver of the debt guarantee fee paid by Hydro to the Shareholder for 2008, increased interest capitalized to development projects, and lower borrowings and interest rates.
- Operations and administration costs were $147.2 million, an increase of $4.1 million over 2007, primarily the result of increased salary related costs ($3.4 million) and loss on disposal of capital assets and other costs ($0.7 million).
- Power purchased costs were $41.0 million, an increase of $2.6 million in 2008, primarily the result of an increase in the volume of power purchases.
- Amortization was $53.1 million, an increase of $2.4 million over 2007, primarily the result of the increasing levels of property, plant and equipment and also the result of marginally higher depreciation levels each year as a result of using the sinking fund method of depreciation.



*Other includes operations and administration costs, amortization expense and asset write-down.

- Fuel expense was $164.8 million compared to $159.2 million in 2007, an increase of $5.6 million, primarily the result of higher unit fuel costs in the regulated utility.
- Nalcor Energy also had a $2.7 million write-down related to an asset in LCDC.

Return on equity (ROE) declined due to the increase in equity from the Shareholder associated with investment in oil and gas developments which are not yet in production. Return on capital employed (ROCE) deteriorated largely due to the impact of increased costs before interest, and lower revenues on an average capital employed base that was largely unchanged from the previous year. Oil and gas investments are still in the development stage and ROCE can be expected to be positively impacted as these developments move into production and generate revenues. The 2007 ROCE figure was restated to reflect the averaging of both debt and equity in the determination of the capital employed base.

BUSINESS SEGMENT REVIEW

In 2008, Nalcor Energy reported its financial results in four business segments: Regulated, Churchill Falls, Oil and Gas and Other Energy Activities. Activities associated with Bull Arm Fabrication are not included in the results and operations of Nalcor Energy at this time. These business segments include the five separate lines of business of Nalcor Energy and are differentiated on the basis of regulatory status and management accountability. The 2008 financial results by business segment are shown in the following table:

millions of dollars	**2008**	2007
Segment income (loss)		
Other Energy Activities	**$ 52.5**	$ 53.6
Churchill Falls	**20.8**	25.1
Regulated	**9.0**	2.9
Oil and Gas	**(0.1)**	-
Net Income	**$ 82.2**	$ 81.6

Regulated

Factors that Shaped 2008 Operations and Business Conditions: The regulated operations of Hydro are impacted by many external factors, primarily, the domestic economy, weather patterns and fuel costs.

In 2008, energy production from the island's hydroelectric plants was higher than in 2007; which, combined with the overall decrease in demand for electricity, resulted in a decrease in the high-cost production from the Holyrood Thermal Generating Station. The resulting variation in fuel costs is deferred into the Rate Stabilization Plan (RSP). The net RSP balance will be collected from or refunded to electricity consumers in the annual RSP rate adjustment.

The increase in regulated net income from $2.9 million in 2007 to $9.0 million in 2008 was primarily due to the waiver of the debt guarantee fee by the Shareholder. In the past, the Government has charged Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Government, outstanding as at the preceding December 31. For 2008, the Government waived the payment of this fee.

Hydro's rates are based on an approved return on regulated equity of 4.47% for the purpose of determining its cost of capital. This level of return is based on a previous Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB) decision which established the ROE at a rate equal to the long-term marginal cost of debt. This return is the lowest approved ROE target of all utilities in Canada and when coupled with a highly leveraged capital structure (83% debt on a regulated basis in 2007 and 2008), results in a limited ability for Hydro to withstand normal fluctuations in costs and revenues without seeking rate changes.

Management's Discussion & Analysis

Revenue: Revenue by major customer category is outlined below:

millions of dollars	**2008**	2007
Newfoundland Power	**$ 342.6**	$ 339.8
Industrial Customers	**33.7**	36.7
Rural Customers	**63.8**	62.2
Other	**2.2**	2.0
Total Revenue	**$ 442.3**	$ 440.7

Revenue from Newfoundland Power increased overall by $2.8 million due to increased RSP recovery offset by a decline in overall sales. Sales to Newfoundland Power decreased by 30.9 GWh, mainly as a result of increased energy production at Newfoundland Power's generation facilities, resulting in a decrease of $2.7 million in revenue. While revenue decreased, the impact on net income was mitigated by offsetting fuel savings derived from reduced generation at the Holyrood plant. This decrease in revenue is offset by an increase in RSP recovery of $5.5 million.

Increase sales to rural customers and other revenues accounted for the remaining $1.8 million increase in total revenue.

Sales to island industrial customers and the Canadian Forces Base in Happy Valley-Goose Bay decreased by 92.2 GWh. This reduction in energy requirement resulted in a $3.0 million reduction in revenue. Sales to the pulp and paper industrial sector were down but were partially offset by increased sales to the oil refinery and mining customers. Fuel savings and related RSP activity as a result of a reduction in sales resulted in minimal impact on Hydro's net income.

Rate Stabilization Plan: The RSP was established in 1986 to mitigate the impact of volatile fuel prices on electricity rates. The difference between the actual cost of fuel consumed to generate electricity and the cost upon which electricity rates are based (cost of service) accumulates in the RSP. Balances which accumulated prior to December 31, 2003, were recovered from customers over a four-year period which commenced in 2004 and ended June 30, 2008. Balances accumulating in the RSP subsequent to 2003 are recovered in each following year, with the exception of the hydraulic variation, which is recovered or refunded at a rate of 25% annually.

The hydraulic variation has been positive in recent years and results from having higher than average water for hydroelectric production, reducing the need for thermal generation and related fuel costs. Rates are also adjusted annually based on forecast fuel prices through a fuel rider.

The rate adjustment for the fuel rider component and accumulated RSP balances becomes effective annually on July 1 for residential and commercial customers and on January 1 for industrial customers.

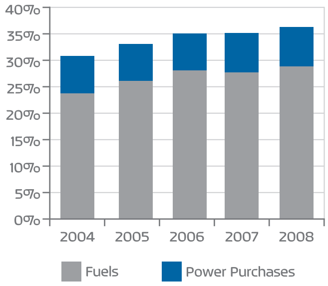
Fuel: Hydro utilizes No. 6 fuel oil at the 490 MW Holyrood Thermal Generating Station and diesel fuel at its 25 diesel plants. The following table summarizes fuel consumed, average purchase price per barrel and total fuel expense.

	2008	2007
No. 6 Fuel		
Consumption (millions of bbl)	**1.7**	2.0
Average purchase price ($/bbl)	**$ 71.6**	$ 52.5

millions of dollars	**2008**	2007
No. 6 fuel/RSP/Other	**$ 149.8**	$ 148.7
Diesel	**15.0**	10.5
Total Fuel Expense	**$ 164.8**	$ 159.2

Fuel expense includes both the cost of No. 6 fuel and fuel costs recognized from the RSP. No. 6 fuel costs declined because production from the Holyrood plant was reduced as a result of higher water levels in the hydro reservoirs, lower customer sales due to reduced power requirements in the pulp and paper industry and higher generation from Newfoundland Power's generation facilities. Overall, total fuel expense in 2008 remained at approximately the 2007 level after accounting for the effects of the RSP.

Five-Year Summary of Hydro's Fuel & Purchased Power Costs as a Percentage of Revenue



Diesel fuel expense increased by $4.5 million, primarily due to higher fuel prices ($3.6 million) and an increase in litres used ($0.9 million). Diesel fuel costs are not included as part of the RSP.

Power Purchased: To supplement Hydro's electricity generation on the island, Hydro purchases power under long-term agreements with non-utility generators (see Note 18(e) to the Consolidated Financial Statements). In Labrador, Hydro purchases substantially all of its energy requirements from Churchill Falls. Total purchased power increased from $38.5 million in 2007 to $41.4 million in 2008. This increase is due to increased purchases from Hydro-Québec for the L'Anse au Loup system and increased purchases from non-utility generators. These increases were offset by a reduction in secondary energy purchases.

Interest: Hydro's net interest expense decreased by $15.6 million from $103.2 million in 2007 to $87.6 million in 2008. The primary driver of this decrease was the waiver of the debt guarantee fee. Lower average debt balances and borrowing costs accounted for the remaining variance.

Operating Costs: Hydro's operating costs comprised 66% (2007 – 68%) of consolidated operating costs as outlined below.

millions of dollars	**2008**	2007
Salaries	**$ 58.5**	$ 58.9
Maintenance	**22.3**	23.5
Other	**18.3**	16.1
Total	**$ 99.1**	$ 98.5

Total operating costs remained at relatively the same levels as 2007. While the overall level of salaries remains relatively unchanged, normal cost of living adjustment increases were offset by additional labour costs capitalized. This was due to an increased capital program and savings that resulted from a reorganization of staff from the regulated business to other parts of Nalcor Energy. Maintenance costs decreased by $1.2 million in 2008 since the 2007 costs included $2.1 million for a major overhaul of Unit #3 at the Holyrood plant. This reduction was offset by a $0.9 million expense related to the turbine repair at the Holyrood plant that had previously been deferred.

In 2008, Abitibi-Consolidated (Abitibi) announced the cessation of paper making and the closure of its Grand Falls pulp and paper mill in February 2009. This decision resulted in the loss of a 20 MW industrial customer for Hydro. Revenue from this customer for the year ended December 31, 2008, was $5.1 million (2007 – $4.9 million).

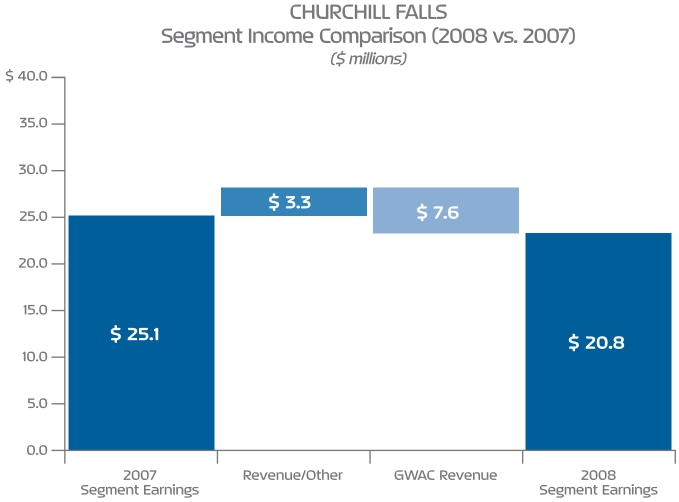
On December 16, 2008, the Abitibi-Consolidated Rights and Assets Act was enacted by the Government of Newfoundland and Labrador, whereby the province assumed control of Abitibi's hydroelectric and timber assets. As a result, two power purchase agreements between Hydro and two non-utility generators, in which Abitibi was a partner, were cancelled. The province has licensed Nalcor Energy to manage and operate the hydro facilities on behalf of the province. Nalcor assumed operations on March 29, 2009.

Management's Discussion & Analysis

Churchill Falls

Nalcor, through its subsidiary, Hydro, holds a 65.8% investment in Churchill Falls, with Hydro-Québec holding the remainder. In 1999, as a result of the Shareholders' Agreement between Hydro, Hydro-Québec and Churchill Falls, Hydro commenced accounting for its investment in Churchill Falls as a joint venture (see Note 1 to Consolidated Financial Statements) and includes 65.8% of the revenues, expenses, assets and liabilities of Churchill Falls in the consolidated accounts.

In 2008, Churchill Falls segment earnings were $20.8 million, a decrease of $4.3 million compared to 2007. Factors contributing to this decrease are the reduction in GWAC revenues of $7.6 million offset partially by an increase in energy sales of $3.5 million. This was due to an increase in energy deliveries to Hydro-Québec and an increase in other costs of $0.2 million. These factors are depicted in the following chart:



On November 3, 2008, a fire occurred in a cable shaft at the plant causing extensive damage to two sets of cables, resulting in two (of the 11) generation units being unavailable. This resulted in a reduction in generating capacity available and a decrease in the GWAC revenue (see Note 21 to the Consolidated Financial Statements). One set of cables has been repaired allowing one unit to be returned to service in late February 2009. Cable repairs to allow the second unit to return to service are scheduled to occur in the summer of 2009. It is anticipated that the estimated costs of the repairs of $10.0 million will be covered by an insurance policy with the exception of a $2.0 million deductible which was expensed in 2008.

Oil and Gas

On August 12, 2008, Oil and Gas Corporation of Newfoundland and Labrador Inc. was incorporated under the Corporations Act of Newfoundland and Labrador and subsequently changed its name to Nalcor Energy – Oil and Gas Inc. on December 18, 2008. Costs capitalized totalled $2.4 million and include legal fees, environmental consulting, project management, Nalcor Energy's share of project development costs and other costs.

In 2008, the company purchased a 4.9% participating interest in the Significant Discovery Licenses and project assets for the Hebron Ben Nevis and West Ben Nevis fields for $110.0 million. In co-operation with the other partners, the company is pursuing development of the oil resources within the Hebron field.

On January 30, 2009, Nalcor Energy – Oil and Gas signed an agreement to purchase a 5.0% working interest in the oil resources contained within the White Rose Growth Project which includes the North Amethyst Field, West White Rose and South White Rose Extension.

Other Energy Activities

Lower Churchill Project: Engineering activities undertaken in 2007 and 2008 included the execution of a field investigation program at the Gull Island site, marine surveys for the Strait of Belle Isle submarine High Voltage direct current (HVDC) crossing, as well as potential submarine HVDC crossings to Nova Scotia and New Brunswick. During 2008, all expenditures related to the development of the lower Churchill resource in Labrador in the amount of $39.9 million were capitalized.

The increase in segment assets reflects the continued pre-sanction investment in the Lower Churchill Project to move towards Decision Gate Two. The effort to assess the feasibility of the development is continuing and has involved further study on the LCP's technical and environmental elements, its configuration and market access options.

Significant engineering and environmental activities took place during 2008 leading to the submission of the Environmental Impact Statement of the generation project in Labrador as well as the initiation of the Environmental Assessment process for the Labrador – Island Transmission Link.

A significant milestone was reached in negotiations with the Innu Nation of Labrador with the establishment of the New Dawn Agreement. The agreement covers three important areas: land claims, impacts and benefits agreements and Upper Churchill redress.

Export Sales: Sales of Recall Power to Hydro-Québec accounted for the majority of the net income for this activity. In 2008, the combined revenues from export sales were $52.6 million (2007 – $54.1 million) and net income was $48.9 million (2007 – $50.3 million). Operating results related to the Menihek Generating Station are also included in this category.

Electricity Sales to Mining Industry: Sales to the iron ore industry in Labrador are from two sources. The first source is through Churchill Falls' joint venture, Twin Falls, and the second is through direct sales by Hydro sourced from Recall Power. These direct sales in 2008 were $5.6 million compared to $4.4 million in 2007.

Business Development: Business development included activities related to Labrador wind, research and development and other business opportunities. During 2008, the business development group continued activity associated with the Ramea Wind-Hydrogen-Diesel Project. The construction of this project, which is expected to be completed during the summer of 2009, aims to develop a wind-hydrogen-diesel energy solution designed for small-scale energy production in isolated locations. Nalcor's collaborating and project partners for Ramea project are the Government of Newfoundland and Labrador; CANMET Energy Technology Centre at NRCan; Faculty of Engineering and Applied Science, Memorial University; and Sustainable Power Research Group, University of New Brunswick. In 2008, none of these activities were in a commercial stage and as a result did not produce any revenues. Costs expensed and capitalized in 2008 were $0.9 million (2007 – $1.7 million) and $3.3 million (2007 – $1.0 million), respectively.

Management's Discussion & Analysis

Other: Investments in the LCDC and GIPCo are included with Other Energy Activities. In 2008, LCDC incurred a write-down related to the expiry of an option to acquire the lower Churchill water rights and GIPCo's assets. This option valued at $5.2 million expired as of November 24, 2008, resulting in an expense for Hydro's 51% share in the amount of $2.7 million. Both companies are inactive and had minimal transactions in 2007 and 2008 with the exception of the transaction previously described.

2009 FINANCIAL OUTLOOK

Nalcor Energy's consolidated financial position for 2009 will be marked by a continuing decline of the debt-to-capital ratio.

It is anticipated that Hydro will fund its 2009 expenditures primarily through internally generated cash flow. Hydro's 2009 funding requirements will be driven primarily by a budgeted capital program of $47.9 million and a planned reduction in short-term debt outstanding. In its 2008-09 Budget, the Government approved a $100.0 million equity contribution to Hydro to improve its debt-to-capital ratio to an acceptable level. It is anticipated that this equity will be received in 2009.

It is anticipated that Churchill Falls will have sufficient cash flow from operations to fund both the 2009 $17.0 million reserve fund payment and 2009 estimated capital expenditures. The approved 2009 capital budget for Churchill Falls is $6.9 million.

The transfer of the Bull Arm Site Corporation from the Shareholder to Nalcor Energy was completed on March 31, 2009. Capital requirements related to Bull Arm are not expected to be material during 2009.

Other factors impacting the 2009 financial outlook for Nalcor Energy include the expiration of the five-year contract with Hydro-Québec for the sale of energy from Recall Power in the first quarter of 2009, as discussed in the Other Energy Activities business segment review. Alternative arrangements for the sale of this energy have been made.

The cable fire in Churchill Falls will result in a loss of a significant portion of GWAC revenue during the first three months of 2009. This loss of revenue is expected to result in lower net income for Nalcor Energy in 2009.

Nalcor Energy continues to analyze and assess other investment opportunities in the longer term that are aligned with the corporate vision statement. Business, financing and risk management strategies are formulated with a view to the longer-term vision of Nalcor Energy.

FINANCIAL CONDITION REVIEW

Assets

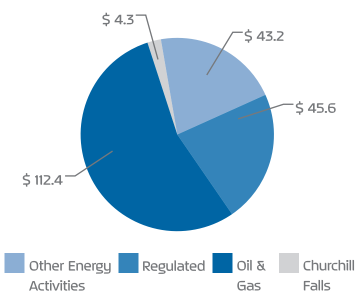
Total assets were $2,479.7 million at December 31, 2008, an increase of $193.4 million or 8.5% over December 31, 2007. There were a number of contributing factors to the increase in assets. Nalcor Energy invested $112.4 million related to the acquisition and development of oil and gas properties. In addition, the company invested $93.1 million in plant and equipment compared to $86.5 million in 2007 as depicted in the following table.

millions of dollars

Capital Expenditures	2008	2007
Regulated	$ 45.6	$ 36.0
Churchill Falls	4.3	4.8
Oil and Gas	112.4	-
Other Energy Activities	43.2	45.7
Total	$ 205.5	$ 86.5

Additions to property, plant and equipment were, in part, offset by amortization of $53.1 million. Short-term investments increased by $13.1 million and the second payment to the Reserve Fund of $11.1 million (Nalcor's share of the $17.0 million contribution by Churchill Falls) was completed during the year. These increases were offset by a decrease in regulatory assets, primarily the continued collection of long-term receivables and a reduction in fuel and supplies inventory of $17.0 million.

2008 Total Capital Expenditures
($ millions)



Liabilities

Total liabilities decreased by $63.3 million from $1,608.5 million at December 31, 2007, to $1,545.2 million at December 31, 2008. The decrease in liabilities was primarily due to the maturity of the $200.0 million series AA debentures during 2008 offset by an increase in promissory notes and regulatory liabilities.

Equity

Total Shareholder's equity increased by $256.7 million from $677.8 million to $934.5 million in 2008. Retained earnings increased at December 31, 2008, compared to December 31, 2007, due to net earnings for 2008 of $82.2 million. Share capital increased by $100.0 million due to the issue of Nalcor shares to its Shareholder. The remaining increase in equity is due to an injection of contributed capital by the Shareholder of $77.5 million offset by a decrease in accumulated other comprehensive income of $3.0 million.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

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

millions of dollars	**2008**	2007
Cash provided by (used in)		
Operating Activities	**$ 174.9**	$ 176.2
Financing Activities	**126.5**	(64.8)
Investing Activities	**(250.0)**	(116.8)
Net increase (decrease) in cash	**$ 51.4**	$ (5.4)

Liquidity requirements are met through a variety of sources, including cash generated from operations, short-term borrowings, and the issuance of long-term debt and contributed equity capital. Nalcor Energy's primary use of funds during 2008 was operating expenses, capital spending including expenditures for the Lower Churchill Project and oil and gas properties, and interest and principal payments on its debt.

Cash from operating activities of $174.9 million was comparable to the previous year and includes net earnings and other non-cash items as well as changes in working capital. Cash from financing activities in the amount of $126.5 million increased by $191.3 million as a result of $177.5 million in equity from the issuance of shares and the injection of contributed capital as well as from the issuance of short-term debt of $156.0 million. This increase was offset by the use of $207.5 million in debt repayments. These funding sources were utilized to fund $250.0 million in investments including $93.1 million in plant and equipment, $112.4 million related to oil and gas investments, sinking fund investments of $20.8 million, reserve fund investments of $11.3 million and short-term investments of $13.1 million.

Management's Discussion & Analysis

Nalcor Energy and its subsidiaries use a combination of short-term and long-term debt and equity instruments to finance operations. Nalcor Energy maintains an unsecured short-term credit facility with a limit of $150.0 million.

Nalcor Energy's subsidiary, Hydro, maintains a short-term promissory note program for funding its daily requirements. This program has an authorized limit of $300.0 million and is guaranteed by the Government. The current credit rating of R1 (low) assigned to this program by Dominion Bond Rating Service (DBRS), combined with the Government guarantee, allows Hydro to access short-term funds in the Canadian Money Market at attractive rates. Unsecured bank credit facilities are also in place in the amount of $50.0 million and with the exception of letters of credit outstanding of $7.5 million, this bank credit facility was largely unencumbered as at the end of 2008.

Capital markets are the principal source of longer-term funding for Hydro. Hydro's debenture issues are currently assigned an "A" credit rating by DBRS, and are also fully guaranteed by the Government. Hydro's total borrowings outstanding, net of sinking funds and exclusive of borrowings pertaining to Churchill Falls, are limited by legislation to $1,612.0 million. As of December 31, 2008, $1,153.8 million was outstanding.

The operations of Churchill Falls are financed by cash from operations. During 2007, debt pertaining to the First Mortgage Bonds ($18.6 million) was retired in full, with the remaining debt outstanding consisting of only the General Mortgage Bonds (GMB), which were secured by Churchill Falls assets. During 2008, the GMB bonds, which bore an interest rate of 7.5% (6% net of subsidies), were refinanced and replaced with a 4.4% fixed rate credit arrangement with principal repayment terms the same as those of the GMBs. In March 2008, Churchill Falls used cash balances to repay $10.0 million of this debt as provided for in the credit agreement leaving a balance outstanding at year end of $45.7 million. Unsecured bank credit facilities are also in place in the amount of $10.0 million and with the exception of letters of credit outstanding of $2.0 million, this bank credit facility was largely unencumbered as at the end of 2008.

Implications of Current Economic Conditions

The current global economic crisis has not impacted, to any significant degree, the availability of short-term funding to Nalcor Energy or any of its subsidiary companies. Covenants under the Nalcor Energy credit facility have not been affected and draw downs to date have been without incident. Borrowing costs under the credit facility are based on Bankers' Acceptance (BA) rates plus a stamping fee of 35 basis points. In January 2008, three-month BAs traded at an average rate of 4.2%. By December 2008, three-month BAs were trading at an average of 1.7%, reflecting a considerable reduction in Nalcor Energy's short-term costs associated with borrowings under this facility.

Hydro continues to raise short-term funding through its promissory note program. The notes issued under this program are guaranteed by the Shareholder. Market receptivity has not been impacted by the current crisis, with a total of $1.1 billion in promissory notes issued during the year. This is nearly five times the issuance in 2007 and is a clear indication of the market depth for Hydro's short-term paper. The higher issuance level was prompted by the decision to fund the Series AA debenture maturity with promissory notes, pending receipt of the anticipated $100.0 million equity contribution from the Shareholder. Borrowing spreads on these notes over Government of Canada three-month treasury bills have decreased from 75 basis points January 2008 to 48 basis points by December 2008. In addition, three-month treasury bill rates have decreased, with the result that all-in rates for Hydro's three-month promissory notes decreased from an average of 4.4% in January 2008 to an average of 2.6% in December 2008, again reflecting a considerable reduction in borrowing costs.

Churchill Falls' cash requirements are funded by cash from operations with periodic working capital needs met through ready access to cash and high quality short-term investments. As at year end, the company had access to nearly $30.0 million in cash and highly liquid short-term investments. It also had access to a reserve fund totalling $36.0 million for use in meeting unanticipated capital expenditures.

Customer demand for both Hydro and Churchill Falls power production has been comparable to that of previous years and does not appear to have been affected to any significant degree by the current financial crisis. Hydro sells a large portion of its power to Newfoundland Power, which is a regulated distribution utility in the province and whose First Mortgage Bonds are rated by Dominion Bond Rating Service as an "A" credit. Churchill Falls' revenue stream is fixed at prices in a long-term power contract with Hydro-Québec.

Nalcor Energy does not foresee problems in preserving its access to short-term funding going forward. Funds from operations are not expected to be impacted to a significant degree by the current economic crisis. As outlined previously, Hydro has access to a stable customer base at regulated rates for the sale of its power. Churchill Falls has accumulated a significant balance in high-quality, short-term investments and has access to a ready market for its power at pricing under long-term contract. If necessary, Nalcor Energy investments may be tempered by financing availability.

The widespread deterioration in the world economy, as it pertains to Nalcor Energy's base energy products, has minimal impact since a significant portion of the revenue base is subject to regulation or long-term power contracts and hence there is considerable price and volume certainty associated with sales. Effective April 1, 2009, the Recall Power sales have changed from a fixed price contract to a contract with market-based pricing for electricity. The overall economy can impact the market prices for these sales. Oil and gas revenues are not expected to represent a significant portion of the company's revenue until 2010, at which time some industry experts are forecasting a degree of price recovery in world oil markets.

CAPITAL STRUCTURE

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

millions of dollars	2008	2007
Short-term debt	$ 163.0	$ 7.0
Current portion of long-term debt	9.1	209.1
Long-term debt (net of sinking funds)	1,011.8	1,036.0
Total debt	$ 1,183.9	$ 1,252.1
Shareholder's equity	$ 934.5	$ 677.8
Total debt to capital(1)	56.0%	65.0%
Fixed rate debt as a percentage of total indebtedness(2)	86.0%	99.0%
EBIT to interest coverage(3)	1.8	1.7

(1) *Debt to Capital – Total debt (promissory notes, long-term debt including current portion less sinking funds), divided by debt plus Shareholder's equity.*
(2) *Long-term debt divided by total debt.*
(3) *EBIT divided by gross interest. Earnings before interest and taxes (EBIT) are computed as net income before taxes and includes interest income but is net of guarantee fees. Gross interest is interest expense before interest income, guarantee fee, capitalized interest, accretion and foreign exchange provision.*

The significant improvement in the capital structure of Nalcor Energy during the year was a direct result of the issuance of shares in the amount of $100.0 million and contributed capital received from the Shareholder in the amount of $77.5 million. This equity funding, combined with a policy to reinvest all earnings, resulted in significantly reduced leverage in Nalcor Energy's capital structure. Improvements in earnings before interest and taxes (EBIT) to interest coverage is due to lower gross interest costs resulting from reduced average debt balances and lower interest rates. It is anticipated that as Nalcor Energy's investments in oil and gas move into the production phase, Nalcor Energy's EBIT to interest coverage will see continued improvement. Nalcor Energy has determined that an improved capital structure and debt servicing capability will be important factors in facilitating its execution of its mandate with respect to the Lower Churchill Project, wind, oil and gas and other investments.

The proportion of fixed rate debt as a percentage of total indebtedness was reduced from 99% at the end of 2007 to 86% at the end of 2008. A return to a higher proportion of fixed rate debt is expected in 2009 to coincide with the planned injection of $100.0 million in equity, which will be applied to floating rate debt outstanding.

OBLIGATIONS AND COMMITMENTS

Obligations and commitments for the five-year period of 2009 to 2013 are as follows:

millions of dollars	2009	2010	2011	2012	2013
Debt Repayments (1)	$ 0.9	$ 29.3	$ -	$ -	$ -
Sinking Fund Installments	8.2	8.2	8.2	8.2	8.2
Reserve Fund Payments (2)	11.2	5.3	5.3	5.3	-
Capital Projects (3)	13.6	-	-	-	-
Power Purchase Agreements (4)	25.6	26.4	29.6	30.0	30.6
Total	$ 59.5	$ 69.2	$ 43.1	$ 43.5	$ 38.8

Notes:
(1) *Includes repayment of long-term debt.*
(2 *In accordance with the Shareholders' Agreement, Churchill Falls is required to establish a $75.0 million Reserve Fund for major repairs, which commenced with an initial payment on January 1, 2007. This item reflects Nalcor Energy's 65.8% share of the total Reserve Fund payments.*
(3) *Includes $6.5 million related to the Lower Churchill Project.*
(4) *Hydro has entered into a number of power purchase agreements with remaining terms ranging from 15 to 26 years.*

RELATED PARTY TRANSACTIONS

Hydro purchases Recall Power from Churchill Falls and in 2008 purchases were $6.0 million (2007 – $6.1 million). Additionally, in the normal course of operations, Nalcor Energy and Hydro provide certain engineering, technical, management and administrative services to Churchill Falls. Fees paid by Churchill Falls to Nalcor Energy and Hydro for these services amounted to $2.2 million in 2007 and 2008.

Payments to the Government are outlined in the table below:

millions of dollars	**2008**	2007
Debt guarantee fee	$ -	$ 13.1
Water rentals and royalties (Churchill Falls)*	**5.0**	5.5
Total	**$ 5.0**	$ 18.6

* Nalcor Energy's share is 65.8%

In addition, during 2008 Hydro received a $0.5 million contribution in aid of construction related to wind feasibility. Hydro also received $0.4 million as a rate subsidy for rural isolated customers and $1.5 million as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated customers under the Government's Northern Strategic Plan.

SECTION 3: MANAGING RISK

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

OPERATIONAL RISK

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

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

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

Management's Discussion & Analysis

Nalcor Energy has initiated a review of its asset management practices to ensure the company manages its equipment effectively and consistently to maximize plant availability and minimize cost. The review is designed to ensure a consistent framework and process across the company and includes a comparison of current maintenance practices to those used by other utilities and industries that have similar equipment.

Safety

The pursuit of safety excellence is a critical focus at Nalcor Energy and all its lines of business. During the year, a two-day Safety Culture Change Workshop was delivered to 40% of the workforce, primarily operations-oriented employees. Integral with this initiative was the development of a set of core values, a new Safety Credo and formal documentation of an Internal Responsibility System for safety. The Safety Culture Change Workshop program will continue throughout 2009 with a goal of participation by all employees. In addition, a number of key safety processes were reviewed and updated including contractor safety management, safety performance communication and personal hazard assessment.

Information Technology

Information technology affects all aspects of Nalcor Energy's operations. Major risk exposures in this environment are: the loss of processing capability due to hardware or software failure, the loss of communication capabilities across the wide-area network and the threat of virus attacks on the company's computer system.

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

The threat of computer virus attacks on Nalcor Energy's computer system is mitigated through the use of firewalls, anti-virus tools and detection/intrusion prevention appliances. Internet access is tightly controlled and managed by a web-filtering device that reduces the risk of picking up malicious code from questionable sites. The company has also initiated increased security measures to align with Shareholder directives to all government departments and Crown agencies.

Environmental

The number and diversity of environmental risks facing the company requires a structured and consistent management approach. Nalcor Energy applies the ISO 14001 Environmental Management System (EMS) standard developed by the International Organization for Standardization to its Hydro and Churchill Falls subsidiaries to drive continual improvement in mitigating environmental risks, while fulfilling its mandate to provide customers with safe, reliable and least-cost power. Targets for improvements in environmental performance for these lines of business are established and monitored as part of the corporate goals and objectives.

Nalcor Energy mitigates environmental risk through adherence to the various principles of the EMS, which include periodic internal environmental compliance audits, surveillance audits by an outside contractor, and recertification as ISO 14001 compliant. Nalcor Energy's application of EMS Standards to the other lines of business will be reviewed in 2009.

Regulatory

Rates that Hydro charges for the provision of electrical service are established by the PUB. In addition to approving the costs that can be recovered in rates, the PUB establishes the return that can be earned in Hydro. This return is currently based on an ROE established at 4.47%, which is substantially lower than other electric utilities in Canada. Management continues to believe that a return comparable to other electric utilities, commensurate with operational risk, is required in order to improve the financial condition of the regulated business and provide a fair return to the Shareholder.

Growth Activities

As Nalcor Energy considers future growth activities in the energy sector, it will be subject to a number of risks specific to these growth activities. As investment opportunities are evaluated, strategies will be devised to mitigate identified risks. With respect to its oil and gas investments, a variety of risks exist that the company has considered during its due diligence process and mitigated where deemed appropriate. These risks include reserve levels, capital costs, oil prices, availability of financing and project development schedules. The impact of global and regional economies, availability of labour, cost inflation, commodity prices, regulatory activities, availability of competitively priced financing and strategic compatibility are considered for all investments being evaluated by the company.

Internal Audit

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

FINANCIAL RISK

Nalcor Energy operates in an environment with various forms of financial risk, including credit, liquidity and price risk. The company utilizes a combination of financial instruments and portfolio management to manage these risks.

Credit Risk

Nalcor Energy is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. The majority of its receivables are from regulated utilities, which minimizes credit risk.

Nalcor manages its cash investment credit risk exposure by restricting its investments to high quality securities. Investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution with the exception of the Government of Canada.

Liquidity Risk

Nalcor Energy is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations and by continuously monitoring cash flows. The funding obligations associated with the longer-term debentures are managed through a balanced approach to debt maturity and a program of sinking fund investment. Debt maturities are managed in a manner that avoids overly demanding funding requirements in any given year.

Management's Discussion & Analysis

Market Risk

Interest Rates

Nalcor Energy has a $150.0 million unsecured revolving-term credit facility, convertible into non-revolving debt. Hydro's short-term funding is managed under a Provincially-guaranteed promissory note program having a $300.0 million limit and a $50.0 million unsecured credit facility with its banker. Churchill Falls maintains a short-term investment portfolio that serves its working capital needs. An unsecured credit facility of $10.0 million is available but rarely utilized.

Nalcor Energy annually establishes clear guidelines for exposure to short-term interest rates and management is regularly apprised of the company's positioning. These exposure limits are reset annually based on an ongoing benchmarking against key indices, coupled with the performance of sensitivity analysis against established risk tolerance levels for each subsidiary. In this manner, the company attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates. As Nalcor Energy continues to increase its energy investments, it will review and revise the floating rate exposure policy as necessary.

Foreign Exchange and Commodity Prices

Nalcor Energy's primary exposure to both foreign exchange and commodity price risk arises primarily from Hydro's purchases of No. 6 fuel for consumption at its Holyrood plant. Hydro's exposure is mitigated through the operation of the RSP. All variances in actual fuel prices, as compared to that approved in Hydro's most recent Cost of Service used to set rates, are captured in the RSP and are either charged or refunded to customers through automatic rate adjustments. Hydro employs the periodic use of forward currency contracts as a means by which future exposure to exchange rate fluctuations on any given day can be avoided. As at December 31, 2008, there were no forward contracts outstanding.

Effective April 1, 2009, Recall Power sales will be based on market prices and denominated primarily in U.S. dollars. The company is reviewing options to address this foreign currency exposure.

Oil and Gas' exposure to both foreign exchange and commodity price risk arises from the sale of its share of crude oil generated from projects in which it has an ownership interest. These sales are denominated in U.S. dollars per barrel of oil. There were no sales during 2008 and none are contemplated until 2010. Foreign currency exposure also exists in the project operating costs, some of which are denominated in U.S. dollars and converted into Canadian dollars. Commodity price and foreign exchange risk as it pertains to oil and gas investments will be managed in a manner that considers earnings volatility and budget objectives.

SECTION 4: CRITICAL ACCOUNTING ESTIMATES

Nalcor Energy's discussion and analysis of its financial condition and results of operations are based on its audited Consolidated Financial Statements, which have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

Significant accounting policies are contained in Note 1 to the audited Consolidated Financial Statements. Some of these policies involve critical accounting estimates requiring particularly subjective or complex judgments about matters that are inherently uncertain which could result in materially different amounts under different conditions or using different assumptions. Management has discussed the development, selection, and application of its key accounting policies and the critical accounting estimates and assumptions they involve, with the Audit Committee of the Board of Directors, and it has reviewed the disclosures described in this section.

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

EMPLOYEE FUTURE BENEFITS

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

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

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

Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation in future periods. These differences relate primarily to actual actuarial gains/losses incurred on the benefit obligation versus those expected, as recognized in the Consolidated Financial Statements. For further details on the annual expense and obligation, see Note 10 to the Consolidated Financial Statements.

ASSET RETIREMENT OBLIGATIONS

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

IMPAIRMENT OF ASSETS

Nalcor Energy reviews the carrying value of its oil and gas properties and deferred development projects at the end of each accounting period. Nalcor Energy reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted cash flows could be lower than the carrying value of the property and assets. When applicable, an impairment loss would be recognized equal to the amount by which the carrying amount exceeds the fair value. Various assumptions and accounting estimates are required to determine whether an impairment loss should be recognized and if so, the value of such loss. This includes factors such as short-term and long-term forecasts of the future market price of electricity and fuel, the demand and supply of electricity and fuel, the in-service dates of new generating stations, inflation, capital expenditures, the size of oil reserves and station lives. The amount of future net cash flow that Nalcor Energy expects to receive from its oil and gas properties and property, plant and equipment could differ materially from the net book values recorded in its Consolidated Financial Statements.

REGULATION

Generally, the accounting policies applicable to Hydro are subject to examination and approval by the PUB. These accounting policies may differ from those used by entities not subject to rate regulation. The timing of the recognition of certain assets, liabilities, revenues and expenses may differ from that otherwise expected using Canadian GAAP for entities not subject to rate regulation. Regulatory assets and regulatory liabilities arise as a result of the rate-setting process and have been recorded based on previous, existing or expected future regulatory orders. Certain estimates are necessary until these amounts are finalized pursuant to regulatory decisions or other regulatory proceedings. The final amounts approved by the PUB for deferral as regulatory assets and regulatory liabilities and the approved recovery or settlement periods may differ from those originally expected. Any resulting adjustments to original estimates are reported in earnings in the period in which they become known. As at December 31, 2008, Hydro had $79.6 million in current and long-term regulatory assets (2007 – $98.5 million) and $53.8 million in current and long-term regulatory liabilities (2007 – $39.0 million). The nature of the company's regulatory assets and liabilities is described in Note 5 to Nalcor Energy's Consolidated Financial Statements.

USEFUL LIFE OF CAPITAL ASSETS

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

Amortization is an estimate based primarily on the anticipated useful life of assets that reflects current facts and historical information. Nalcor Energy's consolidated property, plant and equipment represent approximately 75% of total consolidated assets as at December 31, 2008 (2007 – 80%). Amortization expense associated with property, plant and equipment was $53.1 million during 2008 (2007 – $50.7 million). Due to the size of the company's property, plant and equipment, changes in amortization rates can have a significant impact on amortization expense.

During 2005, pursuant to Order No. P.U. 7 (2002 – 2003), Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management estimated that accumulated amortization is approximately $170.0 – $180.0 million lower than it would otherwise be, and annual amortization expense is $10.0 – $11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. An update to this study began in 2008, and is presently ongoing.

CAPITALIZED OVERHEAD

As approved by the PUB, Hydro capitalizes overhead costs that are not directly attributable to specific capital assets but which relate to the overall capital program. This capital overhead is allocated to property, plant and equipment and amortized over their estimated service lives. In 2008, $3.0 million (2007 – $2.0 million) was allocated. Any change in the methodology of calculating and allocating general overhead costs to property, plant and equipment could have a significant impact on the amount recorded as operating expenses and property, plant and equipment assets.

SECTION 5: ACCOUNTING CHANGES

NEW ACCOUNTING POLICIES

Effective January 1, 2008, Nalcor Energy adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA).

Inventories: Section 3031, Inventory requires inventories to be measured at the lower of cost or net realizable value; disallows the use of last-in-first-out inventory costing methodology; and requires that, when circumstances which previously caused inventories to be written down no longer exist, the amount of the write-down is to be reversed. This new standard did not have any impact on Nalcor Energy's financial results or disclosures in 2008.

Disclosure and Presentation of Financial Instruments: Section 3862, Financial Instruments, Disclosures and Section 3863, Financial Instruments, Presentation sets out new accounting recommendations for disclosure and presentation of financial instruments. The new recommendations require disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the nature and extent of exposure to risks from financial instruments. These new standards did not have any impact on Nalcor Energy's financial results. The additional disclosure is included in Note 14 to Nalcor Energy's Consolidated Financial Statements.

Capital Disclosures: Section 1535, Capital Disclosures requires Nalcor Energy to include additional information in the notes to the financial statements about its capital and the manner in which it is managed. This additional disclosure includes quantitative and qualitative information regarding objectives, policies and processes for managing capital. The additional required disclosure is provided in Note 12 to Nalcor Energy's Consolidated Financial Statements.

FUTURE ACCOUNTING CHANGES

The CICA has issued a number of new accounting standards, which are applicable for the 2009 or subsequent fiscal years. The following provides more information on each new accounting standard:

Goodwill and Intangible Assets: Effective January 1, 2009, Nalcor Energy will adopt Section 3064, Goodwill and Intangible Assets that establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets, and provides more comprehensive guidance particularly with respect to internally developed intangible assets. Nalcor Energy is assessing the effect this new guidance will have on its financial results.

International Financial Reporting Standards (IFRS): In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that all publicly accountable entities in Canada will be required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011.

Nalcor Energy commenced its IFRS conversion project in 2008 and has established a formal project governance structure, which includes a steering committee consisting of senior levels of management from finance and treasury that will be expanded to include representatives from information technology, operations and others as the project progresses. Regular reporting is provided to the Audit Committee of the Board of Directors. In addition to dedicated internal resources, the company has also engaged an external advisor to assist in the IFRS conversion project.

The conversion project consists of three phases – scoping, solution development and implementation. During 2008, Nalcor Energy completed the scoping phase that involved a high level review of the major differences between current Canadian GAAP and IFRS. Currently, the company has determined that the differences which have the highest potential to impact Nalcor Energy are the accounting treatment of regulatory assets and liabilities, and property, plant and equipment, particularly for Hydro, Nalcor Energy's regulated utility. The effects of rate regulation are more fully disclosed in Note 5 to Nalcor Energy's Consolidated Financial Statements. Other areas of potential impact include: impairment of assets; provisions, contingent assets and contingent liabilities; employee benefits, as well as initial adoption of IFRS under the provisions of IFRS 1, First-time Adoption of IFRS. However, the impact of these differences on the company's future financial position and result of operations is not reasonably estimable or determinable at this time.

The solution development phase, to be undertaken in 2009, will involve a more thorough review of the accounting differences and issues identified during the scoping phase, including an analysis of options and alternatives. Nalcor Energy will assess system and process impacts, as well as develop comprehensive communications and training plans.

The implementation phase is expected to commence in late 2009 and will involve finalizing and implementing systems and process changes, preparing comparative financial information, finalizing and obtaining Audit Committee approval of IFRS compliant financial statements, as well as further training and communication to affected stakeholders, as necessary.

Nalcor will continue to review all proposed and continuing projects of the International Accounting Standards Board (IASB), particularly the project on rate-regulated activities that was recently added to the IASB's technical agenda, and proposed amendments to IFRS 1 for entities with operations subject to rate regulation. Nalcor will also closely monitor any International Financial Reporting Interpretations Committee (IFRIC) initiatives with potential to impact the company's financial reporting, and will participate in related processes as appropriate.

SECTION 6: CORPORATE GOVERNANCE

Nalcor Energy's Board of Directors currently consists of six directors, comprised of five independent members drawn from the business community and Nalcor Energy's President and CEO.

The Board of Directors has four committees, all comprised of independent directors: Audit Committee, Corporate Governance Committee, Compensation Committee, and Safety, Health and Environment Committee.

The Audit Committee Chair is a retired partner of a national accounting firm with significant experience with the financial reporting requirements of large publicly-traded companies. The Audit Committee has adopted a number of policies similar to those of publicly-traded companies, including:

- A pre-approval process for non-audit services to be provided by the external auditor, including the identification of prohibited services.

- A policy regarding the hiring of current or former personnel of the external auditor in a financial reporting oversight role.
- Requirement that all members of the Audit Committee have basic financial literacy skills and that at least one member have accounting expertise at a level comparable to the complexity of the company's financial reporting issues.
- Procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

The Corporate Governance Committee is active in ensuring that Nalcor Energy and its subsidiaries maintain a robust governance framework that is built on best practices in entities with similar public accountability, size and complexity. The Compensation Committee provides oversight to all compensation matters in the company, including executive compensation. The Safety, Health and Environment Committee provides oversight with respect to safety, health and environmental targets, performance and practices.

SECTION 7: FORWARD-LOOKING STATEMENTS

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

Management Report

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

The Consolidated Financial Statements have been prepared by Management in accordance with Canadian generally accepted accounting principles, applied on a basis consistent with that of the preceding year. The preparation of financial statements necessarily involves the use of estimates based on Management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to February 20, 2009. Financial information presented elsewhere in the Business Financial Report is consistent with that in the Consolidated Financial Statements.

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

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

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

Ed Martin
President and Chief Executive Officer

Derrick Sturge
Vice President, Finance and Chief Financial Officer

Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Nalcor, as at December 31, 2008 and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. These financial statements are the responsibility of the company's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these Consolidated Financial Statements present fairly, in all material respects, the financial position of Nalcor as at December 31, 2008, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the Energy Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.

Deloitte & Touche

Chartered Accountants
St. John's, NL
Canada
February 20, 2009

Consolidated Balance Sheet

(Note 1)

As at December 31 (millions of dollars)	**2008**	2007
ASSETS		
Current assets		
Cash and cash equivalents	**55.2**	7.2
Short-term investments	**24.6**	11.5
Accounts receivable	**77.1**	80.2
Current portion of long-term receivable	**–**	0.5
Current portion of regulatory assets (Note 5)	**5.0**	17.2
Fuel and supplies	**52.7**	69.7
Prepaid expenses	**1.6**	1.2
	216.2	187.5
Property, plant and equipment (Note 3)	**1,862.8**	1,825.7
Oil and gas properties (Note 4)	**112.1**	–
Sinking funds (Notes 8 and 14)	**163.9**	151.8
Regulatory assets (Note 5)	**74.6**	81.3
Reserve fund (Note 18(b))	**23.4**	11.5
Other long-term assets (Note 6)	**26.7**	28.5
	2,479.7	2,286.3
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness (Note 8)	**5.7**	9.1
Accounts payable and accrued liabilities	**56.4**	75.9
Accrued interest	**28.7**	30.7
Current portion of long-term debt (Note 8)	**9.1**	209.1
Current portion of regulatory liabilities (Note 5)	**22.3**	23.5
Deferred capital contribution (Note 19(e))	**0.5**	–
Promissory notes (Note 8)	**163.0**	7.0
	285.7	355.3
Long-term debt (Notes 8 and 14)	**1,175.7**	1,187.8
Regulatory liabilities (Note 5)	**31.5**	15.5
Employee future benefits (Note 10)	**51.6**	47.4
Long-term payable (Note 9)	**0.7**	–
	83.8	62.9
Non-controlling interest in Lower Churchill Development Corporation (Note 6)	**–**	2.5
Shareholder's equity		
Share capital (Note 11)	**122.5**	22.5
Contributed capital (Note 11)	**191.5**	114.0
Accumulated other comprehensive income (Notes 13 and 14)	**16.5**	19.5
Retained earnings	**604.0**	521.8
	934.5	677.8
	2,479.7	2,286.3
Commitments and contingencies (Note 18)		
Subsequent event (Note 23)		

See accompanying notes

On behalf of the Board:

John Ottenheimer
Director

Gerald Shortall
Director

Consolidated Statement of Income and Retained Earnings

(Note 1)

Year ended December 31 (millions of dollars)	**2008**	2007
Revenue		
Energy sales (Notes 1 and 21)	**563.3**	567.5
Other	**5.9**	5.9
	569.2	573.4
Expenses		
Operations and administration	**147.2**	143.1
Fuels	**164.8**	159.2
Power purchased	**41.0**	38.4
Amortization	**53.1**	50.7
Interest (Note 15)	**78.2**	100.4
Write-down of investment (Note 6(a))	**2.7**	–
	487.0	491.8
Net income	**82.2**	81.6
Retained earnings, beginning of year	**521.8**	437.9
Add: adjustment to long-term debt (Note 14)	**–**	2.3
Retained earnings, end of year	**604.0**	521.8

See accompanying notes

Consolidated Statement of Comprehensive Income

(Note 1)

Year ended December 31 (millions of dollars)	**2008**	2007
Net income	**82.2**	81.6
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments	**(3.0)**	0.2
Comprehensive income	**79.2**	81.8

See accompanying notes

Consolidated Statement of Cash Flow

Year ended December 31 (millions of dollars)	**2008**	(Note 1) 2007
Cash provided by (used in)		
Operating activities		
Net income	**82.2**	81.6
Adjusted for items not involving a cash flow		
Amortization	**53.1**	50.7
Accretion of long-term debt	**0.5**	0.8
Loss on disposal of property, plant and equipment	**2.5**	1.0
Foreign exchange gain	**–**	(0.3)
Write-down of investments	**2.7**	–
Other	**–**	(0.1)
	141.0	133.7
Changes in non-cash working capital balances (Note 16)	**33.9**	42.5
	174.9	176.2
Financing activities		
Increase (decrease) in promissory notes	**156.0**	(51.8)
Long-term debt retired	**(207.5)**	(13.1)
Foreign exchange loss recovered	**–**	0.1
Increase in contributed capital	**77.5**	–
Issue of common shares	**100.0**	–
Increase in deferred capital contribution	**0.5**	–
	126.5	(64.8)
Investing activities		
Additions to property, plant and equipment	**(93.4)**	(86.5)
Additions to oil and gas properties	**(112.1)**	–
Increase in sinking funds	**(20.8)**	(19.6)
(Increase) decrease in short-term investments	**(13.1)**	0.2
Increase in reserve fund	**(11.3)**	(11.5)
Proceeds on disposal of property, plant and equipment	**0.7**	0.6
	(250.0)	(116.8)
Net increase (decrease) in cash	**51.4**	(5.4)
Cash position, beginning of year	**(1.9)**	3.5
Cash position, end of year	**49.5**	(1.9)
Cash position is represented by		
Cash and cash equivalents	**55.2**	7.2
Bank indebtedness	**(5.7)**	(9.1)
	49.5	(1.9)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.1**	0.2
Interest income received	**0.9**	1.2
Interest paid	**101.6**	105.4

See accompanying notes

Notes to Consolidated Financial Statements

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

On October 11, 2007, the Province of Newfoundland and Labrador (Province) proclaimed the Energy Corporation Act, creating a new Crown corporation, Nalcor Energy (Nalcor), to hold its investments in the energy sector. The Consolidated Financial Statements include the financial statements of Nalcor and its subsidiary companies, Newfoundland and Labrador Hydro (Hydro), Churchill Falls (Labrador) Corporation Limited (Churchill Falls), Nalcor Energy – Oil and Gas (Oil and Gas), Twin Falls Power Corporation (Twin Falls), Gull Island Power Corporation (GIPCo) and Lower Churchill Development Corporation (LCDC). Nalcor was inactive until January 1, 2008; therefore the comparative figures included in these Consolidated Financial Statements are those of Hydro consolidated for the year ended December 31, 2007. The transfer of the Province's shares in Hydro to Nalcor was accounted for using the continuity of interests method.

Nalcor and Hydro are incorporated under special acts of the Legislature of the Province as Crown corporations and their core business is the development, generation and sale of electricity. Nalcor has also expanded into the broader energy sector, including oil and gas, wind energy, and research and development.

Churchill Falls is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador that has a rated capacity of 5,428 megawatts (MW). Twin Falls is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Oil and Gas was incorporated August 12, 2008, under the Corporations Act of Newfoundland and Labrador. Oil and Gas has a broad mandate to engage in upstream and downstream sectors of the oil and gas industry including exploration, development, production, transportation and processing.

GIPCo is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland. LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (Lower Churchill Development). Both GIPCo and LCDC are inactive companies.

Nalcor and its subsidiaries and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, environmental and asset retirement obligations, other employee future benefits, amortization, and property, plant and equipment. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2007 – 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 5.

Notes to Consolidated Financial Statements

Principles of Consolidation

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

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

A portion of Hydro's shareholding in Churchill Falls was deposited in a voting trust pursuant to an agreement with Hydro-Québec, in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.

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

Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and bankers' acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than 12 months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments bear interest rates of 1.58% to 3.60% (2007 – 4.12% to 5.00%) per annum.

Fuel and Supplies

Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

Property, Plant and Equipment

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

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

<u>Nalcor and Hydro</u>

Cost includes construction in progress, which includes the costs incurred in feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

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

Notes to Consolidated Financial Statements

Amortization 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%. Amortization 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 plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors, and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching station assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators and conductors.

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

Churchill Falls

Churchill Falls uses the group amortization method for certain property, plant and equipment other than the generation plant, transmission and terminals and service facilities.

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

Hydroelectric generation plant	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Oil and Gas

Property, plant and equipment includes office equipment and software. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. Amortization is calculated on a straight-line basis over the useful life of five years.

Notes to Consolidated Financial Statements

Oil and Gas Properties

Nalcor employs the full cost method of accounting for oil and gas interests whereby all costs associated with acquisition, exploration for and development of oil and gas reserves are capitalized. Such costs include land acquisition, geological and geophysical activity, drilling of wells and administrative costs directly related to exploration and development activities.

Under the full cost method, oil and gas properties are depleted using the unit-of-production method based upon estimated proved petroleum and natural gas reserves. Projects currently in development or construction are not depleted.

Asset Retirement Obligations

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Nalcor's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Nalcor is legally required to remove, an asset retirement obligation will be recognized at that time.

Impairment of Long-lived Assets

Nalcor Energy reviews the carrying value of its oil and gas properties and development projects at the end of each accounting period. Nalcor reviews the carrying value of its other property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition

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

A power contract (Power Contract) with Hydro-Québec, dated May 12, 1969, provides for the sale of substantially all the energy from Churchill Falls until 2041. The Power Contract has a 40-year term to 2016, which then renews for a further term of 25 years. The base rate is predetermined in the Power Contract and decreases from the existing rate of 2.5425 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

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

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, are tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2007 – 7%).

Notes to Consolidated Financial Statements

Foreign Currency Translation

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

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

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(c) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds, which were recoverable under the Power Contract.

Employee Future Benefits

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

Nalcor provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

2. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, Nalcor adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA).

Inventories

Section 3031, Inventory requires inventories to be measured at the lower of cost or net realizable value; disallows the use of last-in-first-out inventory costing methodology; and requires that, when circumstances which previously caused inventories to be written down no longer exist, the amount of the write-down is to be reversed. This new standard did not have any impact on Nalcor's financial results or disclosures.

Disclosure and Presentation of Financial Instruments

Section 3862, Financial Instruments, Disclosures and Section 3863, Financial Instruments, Presentation sets out new accounting recommendations for disclosure and presentation of financial instruments. The new recommendations require disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the nature and extent of exposure to risks from financial instruments. These new standards did not have any impact on Nalcor's financial results. The additional disclosure is included in Note 14 to these financial statements.

Capital Disclosures

Section 1535, Capital Disclosures requires Nalcor to include additional information in the notes to the financial statements about its capital and the manner in which it is managed. This additional disclosure includes quantitative and qualitative information regarding objectives, policies and processes for managing capital. The additional required disclosure is provided in Note 12 to these financial statements.

Notes to Consolidated Financial Statements

3. PROPERTY, PLANT AND EQUIPMENT

	Cost	Contributions in aid of Construction	Accumulated Amortization	Net Book Value
millions of dollars		**2008**		
Electric – generation	**1,678.5**	**27.3**	**547.8**	**1,103.4**
Electric – transmission and distribution	**785.4**	**60.2**	**245.3**	**479.9**
Development projects	**157.0**	**–**	**–**	**157.0**
Other	**346.2**	**32.4**	**191.3**	**122.5**
	2,967.1	**119.9**	**984.4**	**1,862.8**

millions of dollars		2007		
Electric – generation	1,670.5	27.2	531.2	1,112.1
Electric – transmission and distribution	768.0	60.7	229.2	478.1
Development projects	113.8	–	–	113.8
Other	332.3	32.0	178.6	121.7
	2,884.6	119.9	939.0	1,825.7

As at December 31, 2008, the cost of assets under construction and therefore excluded from costs subject to amortization were $169.5 million (2007 – $120.4 million).

4. OIL AND GAS PROPERTIES

millions of dollars	**2008**	2007
Acquisition costs		
Balance – beginning of year	**–**	–
Discovery licenses	**110.0**	–
Balance – end of year	**110.0**	–
Development costs		
Balance – beginning of year	**–**	–
Project development costs	**2.1**	–
Balance – end of year	**2.1**	–
Total – end of year	**112.1**	–

Notes to Consolidated Financial Statements

5. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

Hydro

millions of dollars	**2008**	2007	Remaining Recovery Settlement Period (years)
Regulatory assets			
Long-term receivable	**–**	12.1	–
Foreign exchange losses	**71.1**	73.3	34
Deferred regulatory costs	**0.2**	0.4	1
Deferred major extraordinary repairs	**7.6**	12.3	4
Deferred study costs	**0.2**	0.4	1
Deferred wind power costs	**0.5**	–	1
Total regulatory assets	**79.6**	98.5	
Less current portion	**5.0**	17.2	
	74.6	81.3	
Regulatory liabilities			
Rate Stabilization Plan	**53.2**	38.3	n/a
Deferred purchased power savings	**0.6**	0.7	19
Total regulatory liabilities	**53.8**	39.0	
Less current portion	**22.3**	23.5	
	31.5	15.5	

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

Notes to Consolidated Financial Statements

Rate Stabilization Plan and Related Long-term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a Rate Stabilization Plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002–2003) and Order No. P.U. 40 (2003) RSP balances that accumulated prior to March 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007, and for the utility customers on June 30, 2008, and any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP including financing charges are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of 25% of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2008, $9.1 million was recognized (2007 – $31.5 million) in the RSP and $14.9 million (2007 – $8.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuels expenses.

Foreign Exchange Losses

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

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a 40-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 15).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2008, $0.2 million (2007 – $0.2 million) of amortization was recognized in operations and administration expenses.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset that will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, $2.0 million of

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expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, has been expensed in 2008 (Note 20). In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2008, $2.7 million (2007 – $2.1 million) of amortization was recognized in operations and administration expense.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008) the PUB agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and accordingly, these costs have been recognized as a regulatory asset. These costs will be expensed in 2009. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2008, there were no additions (2007 – $0.2 million) and $0.2 million (2007 – $0.1 million) of amortization was recognized in operations and administration expenses.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2007 – $0.7 million) are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2008, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.3% and the amount capitalized is higher and interest expense is lower by $0.4 million than that which would be permitted in the absence of rate regulation. In 2007, Hydro's AFUDC of 7.6% was lower than its cost of debt of 8.0%, and the amount capitalized was lower and interest expense was higher by $0.3 million than that which would be permitted in the absence of rate regulation (Note 15).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0 – $180.0 million lower than it would otherwise be, and annual amortization expense is $10.0 – $11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. An update to this study began in 2008 and is presently ongoing.

Notes to Consolidated Financial Statements

6. OTHER LONG-TERM ASSETS

millions of dollars	**2008**	2007	
Investment in Lower Churchill Development Corporation Limited	–	5.2	(a)
Long-term receivable	**26.7**	23.3	(b)
	26.7	28.5	

(a) Investment in LCDC

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (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.

Pursuant to the provisions of the Principal Agreement, the Province agreed to enter into an Option Agreement, dated November 24, 1978, with LCDC in respect of GIPCo assets and the hydroelectric development rights to the lower Churchill River, (the Water Rights). In consideration of the option granted from the Province, LCDC issued 520 Class A common shares to Hydro, valued at $5.2 million.

The option provided that upon agreement to continue with the development, LCDC would have acquired the GIPCo assets for the amount of $94.8 million ($100.0 million less the amount of $5.2 million representing the shares issued pursuant to the signing of the Option Agreement). A 10% convertible demand debenture in the amount of $94.8 million would have been issued as consideration for the GIPCo assets and LCDC would have acquired the Water Rights from the Province with the consideration having been the issue of 3,000 Class B common shares without nominal or par value.

On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence, LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement and Hydro's share of the option in the amount of $2.7 million was expensed as an investment write-down in 2008 and the liability to the Government of Canada for non-controlling interest in the amount of $2.5 million was eliminated.

Hydro holds 1,540 Class A common shares of LCDC that 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.

(b) Long-term Receivable

Included in long-term receivables are two refundable deposits in the amount of $25.4 million (2007 – $23.3 million) associated with an application for transmission service into Québec, bearing interest at prime until April 2007 at one-year Guaranteed Income Certificate (GIC) rates thereafter. The remaining portion of $1.3 million (2007 – nil) is a long-term receivable from Hydro-Québec.

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7. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Nalcor's proportionate share of Churchill Falls' assets and liabilities at December 31, 2008, and its proportionate interest in Churchill Falls' operations for the year ended December 31, 2008.

millions of dollars	**2008**	2007
Current assets	**37.0**	39.5
Long-term assets	**334.2**	328.9
Current liabilities	**10.5**	12.5
Long-term liabilities	**29.3**	36.6
Revenues	**65.3**	70.6
Expenses	**50.3**	51.0
Net income	**15.0**	19.6
Cash provided by (used in)		
Operating activities	**30.4**	40.4
Financing activities	**(12.9)**	(19.7)
Investing activities	**(20.0)**	(16.3)

Income tax expense in the amount of $0.2 million (2007 – $0.2 million) related to a jointly controlled subsidiary, Twin Falls, has been grouped with operating expenses.

8. LONG-TERM DEBT

Summary of long-term debt	Hydro	Churchill Falls	Total	Hydro	Churchill Falls	Total
millions of dollars		**2008**			2007	
Long-term debt	**1,154.7**	**30.1**	**1,184.8**	1,359.4	37.5	1,396.9
Less current portion	**8.3**	**0.8**	**9.1**	208.3	0.8	209.1
	1,146.4	**29.3**	**1,175.7**	1,151.1	36.7	1,187.8

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

millions of dollars	2009	2010	2011	2012	2013
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	0.9	29.3	–	–	–
	9.1	37.5	8.2	8.2	8.2

Notes to Consolidated Financial Statements

Nalcor

Nalcor maintains an unsecured revolving term credit facility with its banker in the amount of $150.0 million Canadian or U.S. equivalent. Borrowings in Canadian dollars may take the form of Prime Rate advances, Bankers' Acceptances (BAs), and Letters of Credit. Borrowings in U.S. dollars may take the form of Base Rate advances, LIBOR Advances and Letters of Credit. The facility also provides coverage for overdrafts on Nalcor's bank accounts, with interest calculated at the Prime Rate. The terms of the credit facility provide for the expansion of the facility up to $300.0 million Canadian or U.S. equivalent as a non-revolving term credit facility, secured by the guarantee of the Province. At year-end, the only drawing on the facility was one irrevocable letter of credit issued on behalf of Nalcor's subsidiary, Oil and Gas. This letter of credit, in the amount of $1.5 million, was issued to the Canada-Newfoundland and Labrador Offshore Petroleum Board (C-NLOPB) to satisfy certain financial responsibility requirements specified in the Accords Acts with respect to the issuance of authorizations for petroleum-related work or activities within the Newfoundland and Labrador offshore area.

Hydro

Series	Face Value	Coupon Rate %	Year of Issue	Year of Maturity		
millions of dollars					**2008**	2007
AA	200.0	5.50	1998	2008	–	199.9
V*	125.0	10.50	1989	2014	**124.5**	124.4
X*	150.0	10.25	1992	2017	**149.1**	149.0
Y*	300.0	8.40	1996	2026	**292.9**	292.7
AB*	300.0	6.65	2001	2031	**306.9**	307.1
AD*	125.0	5.70	2003	2033	**123.5**	123.5
AE*	225.0	4.30	2006	2016	**223.5**	223.3
Total debentures	1,425.0				**1,220.4**	1,419.9
Less sinking fund investments in own debentures					**65.9**	60.8
					1,154.5	1,359.1
Other					**0.2**	0.3
					1,154.7	1,359.4
Less payments due within one year					**8.3**	208.3
					1,146.4	1,151.1

** Sinking funds have been established for these issues.*

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2007 – 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1.0% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008, the Province waived the payment of this fee.

Notes to Consolidated Financial Statements

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at interest rates ranging from 1.40% to 2.90% (2007 – 4.30% to 4.45%).

Hydro maintains a $50.0 million Canadian or U.S. equivalent unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2007 – nil). Advances may take the form of a prime rate advance or the issuance of a BA with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate. At year-end, Hydro had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by $7.5 million.

Churchill Falls

millions of dollars	**2008**	2007
General Mortgage Bonds		
7.5% due December 15, 2010	–	37.5
Less: current portion	–	0.8
Total long-term debt	–	36.7
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010	**30.1**	–
Less: current portion	**0.8**	–
Total long-term debt	**29.3**	–

<u>Refinancing</u>

On February 25, 2008, Churchill Falls completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.5% (6.0% net of subsidies) were retired and replaced with a 4.4% fixed rate credit agreement with The Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds, which provided for semi-annual payments in an amount equal to 1.0% of the aggregate principal amount outstanding on January 1 preceding each payment date with a final principal payment due in 2010.

Churchill Falls exercised its prepayment privileges under the new credit agreement by prepaying $10.0 million principal on March 25, 2008. Nalcor's share of this repayment was $6.6 million.

<u>Dividend Restriction</u>

Under the terms of the long-term debt instruments, Churchill Falls may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A Shareholders' agreement signed in June 1999 places additional restrictions on dividends based on cash flow.

<u>Operating Credit Facility</u>

Churchill Falls maintains a $10.0 million Canadian or U.S. equivalent unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2007 – $0.3 million). Advances may take the form of a Prime Rate advance or the issuance of BAs with interest calculated at the Prime Rate or prevailing Government BA fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year-end, Churchill Falls had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by $1.4 million.

Notes to Consolidated Financial Statements

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec as of December 31, 2008, is the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of $0.7 million (2007 – nil) is long-term. The final amount will be determined on August 31, 2012, and will be paid/collected monthly beginning September 2012 and ending August 2016.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.9 million (2007 – $4.6 million) are expensed as incurred.

Other Benefits

Additionally, Nalcor provides group life insurance and health care benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2008, cash payments to beneficiaries for its unfunded other employee future benefits was $3.0 million (2007 – $2.3 million). The most recent actuarial valuation was performed as at December 31, 2006, with an extrapolation of the December 31, 2006 valuation to December 31, 2008. The next actuarial valuation will be performed as at December 31, 2009.

millions of dollars	**2008**	2007
Accrued benefit obligation		
Balance at beginning of year	**68.6**	67.8
Current service cost	**2.2**	2.3
Interest cost	**3.8**	3.6
Actuarial gain	**(19.3)**	(2.8)
Benefits paid	**(3.0)**	(2.3)
Balance at end of year	**52.3**	68.6
Plan deficit	**52.3**	68.6
Unamortized actuarial loss	**(0.4)**	(20.9)
Unamortized past-service cost	**(0.3)**	(0.3)
Accrued benefit liability at end of year	**51.6**	47.4

millions of dollars	**2008**	2007
Components of benefit cost		
Current service cost	**2.2**	2.3
Interest cost	**3.8**	3.6
Actuarial gain	**(19.3)**	(2.8)
	(13.3)	3.1
Adjustments		
Difference between actual actuarial gain and amount recognized	**20.4**	4.3
Benefit expense	**7.1**	7.4

Notes to Consolidated Financial Statements

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

	2008	2007
Discount rate	**7.5%**	5.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed health care trend rates:

	2008	2007
Initial health care expense trend rate	**7.0%**	8.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2011**	2011

A 1% increase in assumed health care trend rates would have had the following effect:

millions of dollars	**2008**	2007
Current service and interest cost	**1.2**	0.8
Accrued benefit obligation	**7.2**	5.7

A 1% decrease in assumed health care trend rates would have had the following effect:

millions of dollars	**2008**	2007
Current service and interest cost	**(0.8)**	(0.8)
Accrued benefit obligation	**(5.5)**	(9.2)

11. SHAREHOLDER'S EQUITY

Share Capital

millions of dollars	**2008**	2007
Common shares		
Authorized: unlimited; issued 122,500,000 (2007 – 22,503,924)	**122.5**	22.5

In 2007, the Province held 22,503,924 shares in Hydro with a value of $22.5 million and pursuant to the Hydro Corporation Act, 2007, these shares were transferred to Nalcor. This transfer of shares was accounted for using the continuity of interests method. During 2008, Nalcor issued an additional 99,996,076 shares with a value of $100.0 million.

Contributed Capital

millions of dollars	**2008**	2007
Total contributed capital	**191.5**	114.0

During 2008, the Province contributed capital in the amount of $77.5 million.

Notes to Consolidated Financial Statements

12. CAPITAL MANAGEMENT

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

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

A summary of the capital structure is outlined below:

millions of dollars	**2008**		2007	
Debt				
Long-term debt	**1,175.7**		1,187.8	
Current portion of long-term debt	**9.1**		209.1	
Promissory notes	**163.0**		7.0	
Sinking funds	**(163.9)**		(151.8)	
	1,183.9	**55.9%**	1,252.1	64.9%
Equity				
Share capital	**122.5**		22.5	
Contributed capital	**191.5**		114.0	
Accumulated other comprehensive income	**16.5**		19.5	
Retained earnings	**604.0**		521.8	
	934.5	**44.1%**	677.8	35.1%
Total debt and equity	**2,118.4**	**100.0%**	1,929.9	100.0%

Hydro

Hydro requires access to capital due to the capital intensive nature of the business that is required to ensure the continued delivery of safe and reliable service to its customers. Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes (EBIT) coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the Shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flows to support debt.

Churchill Falls

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

At present, the capital position of Churchill Falls is weighted heavily toward equity capital (share capital and retained earnings). The only remaining long-term debt at the end of the year consisted of a loan from the Bank of Nova Scotia, the balance of which comprised less than 10% of the total capital structure. This loan carries the same terms of repayment as the former General Mortgage Bonds and will mature in December of 2010, with any remaining principal due at that time. Churchill Falls

Notes to Consolidated Financial Statements

has the right to prepay under certain conditions and has already taken advantage of the opportunity to do so. On March 19, 2008, Churchill Falls exercised its prepayment rights under the Credit Agreement to prepay $10.0 million in principal effective March 25, 2008. The corporate strategy is to ensure that funding is in place to extinguish the entire debt by the end of 2010 without re-financing. The capital structure is adjusted through the amount of dividends paid to Shareholders.

Oil and Gas

Future requirements for capital are expected to increase, coincident with the increase in projects in development. Capital costs to date have been financed by equity. Once projects reach the production stage Oil and Gas' cash from operations will contribute to funding its capital requirements.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair value of sinking fund and reserve fund investments comprise the items in other comprehensive income.

millions of dollars	**2008**	2007
Balance, beginning of year	**19.5**	–
Adjustment due to the adoption of new accounting policies	–	19.3
Change in fair value of sinking fund investments	**(3.6)**	0.2
Change in fair value of reserve fund investments	**0.6**	–
Balance, end of year	**16.5**	19.5

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Nalcor has classified its financial instruments as follows:

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

Each of these financial instruments is measured at amortized cost, except for the reserve fund, sinking fund – other investments and cash and cash equivalents, which are measured at fair value.

Notes to Consolidated Financial Statements

Fair Value

The estimated fair values of financial instruments as at December 31, 2008, are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Nalcor might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Nalcor as a whole.

In 2007, Nalcor recognized an increase to opening retained earnings of $2.3 million resulting from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Nalcor recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of $19.3 million.

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars	**2008**		2007	
Financial liabilities				
Long-term debt including current portion	**1,184.8**	**1,484.8**	1,396.9	1,731.2

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

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Nalcor's business.

Credit Risk

Nalcor is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities, which minimizes credit risk. There is risk that Nalcor will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments that arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Nalcor manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Nalcor manages its investment credit risk exposure by restricting its investments to high-quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks. Additionally, the investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution with the exception of the Government of Canada.

Liquidity Risk

Nalcor is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and credit facilities. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues. In addition, the reserve fund in Churchill Falls and the dividend management policy is used to meet long-term liquidity requirements associated with debt retirement and capital expenditure programs.

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Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates.

Interest Rates: Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Nalcor attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Within Hydro, exposure to changes in interest rates on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios creates risk. Hydro estimates that an increase of 100 basis points from the actual average yield on the short-term debt portfolio in 2008 would have resulted in a change in interest expense of $1.3 million (2007 – $0.2 million). Similarly, an increase of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2008 would have resulted in a change in interest income of $2.0 million (2007 – $1.8 million) and a decrease in other comprehensive income of $16.1 million (2007 – $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

Within Churchill Falls, interest rate risk is mitigated on the company's long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that an increase of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2008 would have resulted in a change in interest income of $0.2 million (2007 – $0.2 million). Similarly, an increase of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2008 would have resulted in a change in interest income of $0.2 million (2007 – $0.1 million) and an increase in other comprehensive income of $0.5 million (2007 – $0.2 million). Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated.

Foreign Currency and Commodity Exposure: Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Nalcor's primary exposure to both foreign exchange and commodity price risk arise from activities within Hydro from its purchases of No. 6 fuel for consumption at the HTGS. During 2008, Hydro had total purchases of No. 6 fuel of $103.9 million (2007 – $122.0 million). These purchases are denominated in U.S. dollars.

Nalcor's exposure to both the foreign exchange and commodity price risk associated with these purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either refunded to or collected from customers via automatic rate adjustments. Nalcor also employs the periodic use of forward currency contracts as a means by which exposure to exchange rates on a particular day can be avoided. As at December 31, 2008, there were no forward contracts outstanding.

Notes to Consolidated Financial Statements

15. INTEREST EXPENSE

millions of dollars	**2008**	2007
Gross interest		
Long-term debt	**96.0**	105.0
Promissory notes	**4.2**	0.9
	100.2	105.9
Accretion of long-term debt	**0.5**	0.8
Provision for foreign exchange losses	**2.2**	2.2
	102.9	108.9
Less		
Recovered from Hydro-Québec	**0.1**	1.0
Interest capitalized during construction	**9.6**	6.3
Interest earned	**15.0**	14.3
Net interest expense	**78.2**	87.3
Debt guarantee fee	**–**	13.1
Net interest and guarantee fee	**78.2**	100.4

Under the terms of the Power Contract, Churchill Falls recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt. In addition, with the refinancing of the General Mortgage Bonds, Churchill Falls is required to share with Hydro-Québec any benefits it receives resulting from the refinancing.

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such requests fail to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

16. CHANGE IN NON-CASH WORKING CAPITAL BALANCES

millions of dollars	**2008**	2007
Accounts receivable	**3.1**	(7.8)
Fuel and supplies	**17.0**	(15.3)
Prepaid expenses	**(0.4)**	0.3
Accounts payable and accrued liabilities	**(19.5)**	26.7
Regulatory assets	**18.9**	49.7
Regulatory liabilities	**14.8**	(11.3)
Accrued interest	**(2.0)**	(0.1)
Employee future benefits	**4.2**	5.1
Long-term receivable	**(2.9)**	(4.5)
Long-term payable	**0.7**	(0.3)
	33.9	42.5

17. SEGMENT INFORMATION

Nalcor operates in four business segments. Regulated operations encompass sales of power and energy to most customers within the Province while Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Other energy activities are primarily engaged in sales to markets outside the province and development activities. Oil and Gas activities include exploration, development, production, transportation and processing sectors of the oil and gas industry. The designation of segments has been based on a combination of regulatory status and management accountability. The segment's accounting policies are the same as those described in Note 1.

Notes to Consolidated Financial Statements

	Regulated	Other Energy Activities	Churchill Falls	Oil and Gas	Inter-segment	Total
millions of dollars			**2008**			
Revenue						
Energy sales	**440.1**	**58.2**	**68.9**	**–**	**(3.9)**	**563.3**
Other	**2.2**	**–**	**0.3**	**0.3**	**3.1**	**5.9**
	442.3	**58.2**	**69.2**	**0.3**	**(0.8)**	**569.2**
Expenses						
Operations and administration	**99.1**	**8.9**	**38.8**	**0.4**	**–**	**147.2**
Fuels	**164.8**	**–**	**–**	**–**	**–**	**164.8**
Power purchased	**41.4**	**3.5**	**–**	**–**	**(3.9)**	**41.0**
Amortization	**40.4**	**0.1**	**11.4**	**–**	**1.2**	**53.1**
Interest	**87.6**	**(9.5)**	**0.1**	**–**	**–**	**78.2**
Write-down of investment	**–**	**2.7**	**–**	**–**	**–**	**2.7**
	433.3	**5.7**	**50.3**	**0.4**	**(2.7)**	**487.0**
Net income before equity in Churchill Falls	**9.0**	**52.5**	**18.9**	**(0.1)**	**1.9**	**82.2**
Equity in Churchill Falls	**–**	**11.8**	**–**	**–**	**(11.8)**	**–**
Preferred dividends	**–**	**9.0**	**–**	**–**	**(9.0)**	**–**
Net income	**9.0**	**73.3**	**18.9**	**(0.1)**	**(18.9)**	**82.2**
Capital expenditures	**45.6**	**43.2**	**4.3**	**112.4**	**–**	**205.5**
Total assets	**1,711.5**	**723.0**	**371.2**	**112.7**	**(438.7)**	**2,479.7**

During 2008, sales to Nalcor's three largest customers amounted to 90% of total energy sales revenue (2007 – 90%).

	Regulated	Other Energy Activities	Churchill Falls	Oil and Gas	Inter-segment	Total
millions of dollars			2007			
Revenue						
Energy sales	438.7	58.5	74.2	–	(3.9)	567.5
Other	2.0	–	0.3	–	3.6	5.9
	440.7	58.5	74.5	–	(0.3)	573.4
Expenses						
Operations and administration	98.5	6.0	38.6	–	–	143.1
Fuels	159.2	–	–	–	–	159.2
Power purchased	38.5	3.9	–	–	(4.0)	38.4
Amortization	38.4	–	11.2	–	1.1	50.7
Interest	103.2	(5.0)	2.1	–	0.1	100.4
	437.8	4.9	51.9	–	(2.8)	491.8
Net income before equity in Churchill Falls	2.9	53.6	22.6	–	2.5	81.6
Equity in Churchill Falls	–	14.7	–	–	(14.7)	–
Preferred dividends	–	10.4	–	–	(10.4)	–
Net income	2.9	78.7	22.6	–	(22.6)	81.6
Capital expenditures	36.0	45.7	4.8	–	–	86.5
Total assets	1,733.3	498.9	368.4	–	(314.3)	2,286.3

Notes to Consolidated Financial Statements

Geographic Information

Revenues by geographic area:

millions of dollars	**2008**	2007
Newfoundland and Labrador	**447.6**	445.1
Québec	**121.6**	128.3
	569.2	573.4

All of Nalcor's assets are located in the Province.

18. COMMITMENTS AND CONTINGENCIES

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

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

(b) Pursuant to the terms of the 1999 Shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested $17.0 million in each of 2007 and 2008. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2009	$17.0 million
January 1, 2010	$8.0 million
January 1, 2011	$8.0 million
January 1, 2012	$8.0 million

This fund must remain in place until the end of the Shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holding consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Banks. Nalcor's share of this commitment is 65.8%.

A summary of Nalcor's 65.8% share of the reserve fund is as follows:

millions of dollars	**2008**	2007
Opening balance	**11.2**	–
Contribution	**11.2**	11.2
Total contribution to reserve fund	**22.4**	11.2
Net interest earned	**0.4**	0.3
Mark-to-market adjustment	**0.6**	–
Fair value of reserve fund	**23.4**	11.5

Notes to Consolidated Financial Statements

(c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.2 million (2007 – $1.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.2 million (2007 – $21.8 million) related to outages and plant shutdowns. Hydro is defending this claim and management believes that this claim will not be successful.

(d) Outstanding commitments for capital projects total approximately $13.6 million (2007 – $16.8 million).

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

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

During 2008, the enactment of the Abitibi-Consolidated Rights and Assets Act resulted in the cancellation of two long-term power purchase agreements (Note 21(a)).

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

millions of dollars	2009	2010	2011	2012	2013
Power purchases	25.6	26.4	29.6	30.0	30.6

(f) Nalcor has issued a letter of credit, in the amount of $1.5 million, to CNLOPB to satisfy certain financial responsibility requirements specified in the Accords Acts with respect to the issuance of authorizations for petroleum-related work or activities within the Newfoundland and Labrador offshore area.

Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to an application for point-to-point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement.

Churchill Falls has issued two irrevocable letters of credit, in the amount of $0.7 million each to ensure satisfactory management of its waste management and compliance with a Certificate of Approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

Notes to Consolidated Financial Statements

19. RELATED PARTY TRANSACTIONS

The Province, Nalcor, Hydro, Churchill Falls, Oil and Gas, LCDC and GIPCo are related parties. In addition, the PUB is related to Nalcor by virtue of its status as an agency of the Province.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.0 million (2007 – $6.1 million) of the power produced by Churchill Falls and Nalcor's 65.8% share is eliminated upon consolidation.

(b) For the year ended December 31, 2008, approximately $2.2 million (2007 – $2.2 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties and Nalcor's 65.8% share is eliminated upon consolidation.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2008, Hydro incurred $0.6 million in costs related to the PUB (2007 – $1.2 million) of which $0.1 million (2007 – $0.1 million) was included in accrued liabilities.

(d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually.

(e) During 2008, Hydro received contribution in aid of construction from the Province related to wind feasibility studies. As at December 31, 2008, the full amount of $0.5 million has been recorded as deferred capital contribution.

(f) During 2008, Hydro received $0.4 million (2007 – nil) as a rate subsidy for rural isolated customers from the Province and $1.5 million (2007 – $0.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2007 – $0.6 million) recorded as accounts receivable at year-end.

20. CHANGE IN ESTIMATE

In 2007, Hydro incurred $2.0 million in expenses to repair a turbine at HTGS and these costs were deferred as a major extraordinary repair. Pursuant to Order No. P.U. 31 (2008), the PUB denied Hydro's request to treat the repair of the turbine as a major extraordinary repair and therefore, the full cost of the repair, net of insurance proceeds of $0.8 million, was recorded in operations and administration expense during 2008.

21. SIGNIFICANT OCCURRENCES

Hydro

In late 2008, Abitibi-Consolidated announced the shut-down of the Grand Falls Pulp and Paper Mill resulting in the loss of a major industrial customer. Revenue from this customer for the year-ended December 31, 2008, was $5.1 million (2007 – $4.9 million). The Abitibi-Consolidated Rights and Assets Act was enacted on December 16, 2008, resulting in the cancellation of two power purchase agreements from two non-utility generators in which Abitibi was a partner.

Churchill Falls

On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high voltage cables in two units of the cable shaft.

Repair work has begun on one unit with work expected to be completed in February 2009. The second unit will be repaired in the summer of 2009 once the necessary cables have been obtained. Nalcor's estimated share of the cost of the repair to the cables in the amount of $6.6 million is covered by an insurance policy with a $1.3 million deductible. As at December 31,

Notes to Consolidated Financial Statements

2008, Nalcor's share of expenses totaling $1.5 million have been incurred in relation to this repair and insurance proceeds of $0.2 million have been accrued. Churchill Falls will accrue the expenses and related insurance proceeds as incurred.

Nalcor's 65.8% share of the total impact of the fire on net income for the year-ended December 31, 2008, including lost revenue is estimated to be as follows:

millions of dollars	**2008**
Lost revenue – guaranteed winter availability	**(8.4)**
Lost revenue – power sales	**(2.1)**
Repair costs (net of insurance proceeds)	**(1.3)**
Net decrease in rental and other costs	**0.8**
Total impact on net income	**(11.0)**

22. OIL AND GAS INTERESTS

In 2008, Oil and Gas purchased a 4.9% participating interest in the Significant Discovery Licences (SDL) and project assets for the Hebron Ben Nevis and West Ben Nevis fields for a purchase price of $110.0 million. In co-operation with the other partners, Oil and Gas is pursuing development of the oil resources within the Hebron field.

23. SUBSEQUENT EVENT

On January 30, 2009, Oil and Gas signed an agreement to purchase a 5% working interest in the oil resources contained within the White Rose Growth Project, which includes the North Amethyst Field, West White Rose and the South White Rose Extension. The purchase price was a maximum of $30.0 million, net of HST, to be paid in two installments. The first installment of $7.0 million was paid on January 30, 2009; the remaining payment of $23.0 million will be made upon the determination of the West White Rose Extension oil reserves. This payment will be dependent on the extent of these oil reserves but will be no more than $23.0 million.

Financial Statistics

Year ended December 31 (millions of dollars)	**2008**	2007	2006	2005	2004
OPERATING RESULTS					
Revenue					
Energy sales	**563.3**	567.5	541.8	526.8	488.6
Other	**5.9**	5.9	6.2	5.7	4.9
	569.2	573.4	548.0	532.5	493.5
Expenses					
Operations and administration	**147.2**	143.1	130.4	130.8	123.4
Fuels and power purchased	**205.8**	197.6	193.4	176.9	153.4
Amortization	**53.1**	50.7	48.5	47.0	45.8
Interest	**78.2**	100.4	105.7	105.9	103.7
Write down of investment	**2.7**	–	–	–	–
	487.0	491.8	478.0	460.6	426.3
Net income	**82.2**	81.6	70.0	71.9	67.2
Contributions to net income (loss)					
Regulated	**9.0**	2.9	(6.7)	3.3	7.2
Other Energy Activities	**52.5**	53.6	50.3	47.2	40.4
Churchill Falls	**20.8**	25.1	26.4	21.4	19.6
Oil and Gas	**(0.1)**	–	–	–	–
GIPCo	**–**	–	–	–	–
LCDC	**–**	–	–	–	–
FINANCIAL POSITION					
Total current assets	**216.2**	187.5	196.4	181.9	171.6
Total current liabilities	**285.7**	355.3	201.5	469.2	273.6
Net working capital	**(69.5)**	(167.8)	(5.1)	(287.3)	(102.0)
Property, plant and equipment	**2,847.2**	2,764.7	2,684.7	2,632.6	2,600.8
Accumulated depreciation	**984.4**	939.0	893.2	851.0	816.3
Property, plant and equipment, net	**1,862.8**	1,825.7	1,791.5	1,781.6	1,784.5
Oil and gas properties	**112.1**	–	–	–	–
Sinking funds	**163.9**	151.8	117.1	85.8	72.6
Other assets	**124.7**	121.3	127.3	154.8	187.9
Long-term debt	**1,175.7**	1,187.8	1,394.7	1,174.8	1,407.6
Other liabilities	**83.8**	65.4	61.7	53.1	44.5
Shareholder's equity	**934.5**	677.8	574.4	507.0	490.9
STAFFING LEVELS					
Full-time equivalents	**1,185**	1,173	1,147	1,144	1,149

Operating Statistics

Year ended December 31	**2008**	2007	2006	2005	2004
INSTALLED GENERATING CAPACITY (rated MW)					
Churchill Falls	**5,428**	5,428	5,428	5,428	5,428
TWINCo	**225**	225	225	225	225
Hydro – Hydraulic					
Hydraulic	**939**	939	939	939	939
Thermal	**640**	640	640	640	640
Diesel	**56**	56	56	56	57
Menihek*	**19**	19	–	–	–
Total	**7,307**	7,307	7,288	7,288	7,289
ELECTRIC ENERGY GENERATED, NET (GWh)					
Churchill Falls	**34,847**	33,254	34,663	33,563	32,800
Hydro					
Hydraulic	**4,771**	4,689	4,802	4,770	4,726
Thermal	**1,071**	1,243	730	1,321	1,642
Diesel	**47**	43	42	43	47
Menihek*	**41**	13	–	–	–
Total	**40,777**	39,242	40,237	39,697	39,215
ELECTRIC ENERGY SALES (GWh)					
Churchill Falls Export	**30,007**	28,566	29,835	28,748	28,330
Hydro					
Utility	**4,960**	4,991	4,617	4,664	4,709
Rural	**909**	888	834	859	886
Industrial	**1,124**	1,136	1,145	1,685	1,842
Export	**1,393**	1,489	1,483	1,422	1,456
Menihek* Export	**41**	13	–	–	–
TwinCo Industrial	**1,801**	1,678	1,801	1,804	1,469
Total	**40,236**	38,761	39,715	39,182	38,692
AVERAGE RATE (cents per kWh)					
Churchill Falls Export	**0.25**	0.25	0.25	0.25	0.26
Hydro					
Utility	**6.48**	6.50	5.24	5.25	4.99
Rural	**7.02**	6.98	6.13	6.13	5.87
Industrial	**4.04**	4.21	3.71	3.43	3.24
Export	**3.68**	3.61	3.55	3.48	3.41
Menihek* Export	**3.19**	2.91	–	–	–
TRANSMISSION LINES (km)					
Churchill Falls					
735 kV	**608**	608	608	608	608
230 kV	**431**	431	431	431	431
Hydro					
230 kV	**1,608**	1,608	1,608	1,608	1,608
138 kV	**1,500**	1,500	1,500	1,500	1,500
69 kV	**634**	634	634	634	589
Menihek*					
69 kV	**39**	39	–	–	–
Total	**4,820**	4,820	4,781	4,781	4,736
PEAK DEMAND (MW)					
Churchill Falls	**4,501**	5,575	5,587	5,608	5,645
Hydro System	**1,323**	1,323	1,310	1,361	1,405

** Operations commenced October 1, 2007.*

Nalcor Energy Executive Leadership Team

Ed Martin
President & CEO
Nalcor Energy

Gilbert Bennett
Vice President
Nalcor Energy – Lower Churchill Project

Jim Haynes
Vice President Regulated Operations
Newfoundland and Labrador Hydro

Jim Keating
Vice President
Nalcor Energy – Oil and Gas

Chris Kieley
Vice President Strategic Planning
& Business Development
Nalcor Energy

Andy MacNeill
Vice President
Nalcor Energy – Churchill Falls

John Mallam
Vice President Engineering Services
Newfoundland and Labrador Hydro

Gerard McDonald
Vice President Human Resources
& Organizational Effectiveness
Nalcor Energy

Derrick Sturge
Vice President Finance & CFO
Nalcor Energy

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Lawyer
Corporate Director

Cathy Bennett
Owner/Operator
Bennett Restaurants Ltd.

Tom Clift [1,3]
Associate Dean, Academic Programs
Memorial University – Faculty of Business

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

Ed Martin
President & CEO
Nalcor Energy

Gerald Shortall [2,3]
Chartered Accountant
Corporate Director

1 – Compensation Committee
2 – Audit Committee
3 – Corporate Governance Committee

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