LOWER CHURCHILL PROJECT COMPANIES
COMBINED AUDITED FINANCIAL STATEMENTS
December 31, 2013

LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENT OF FINANCIAL POSITION

As at December 31 (thousands of Canadian dollars)	Notes	**2013**	2012
ASSETS			
Current assets			
Cash and cash equivalents	5	**1,952**	-
Restricted cash	5	**525,472**	-
Trade and other receivables		**2,967**	-
Prepaid interest		**1,239**	-
Total current assets		**531,630**	-
Non-current assets			
Property, plant and equipment	6	**1,076,879**	126,816
Advances	7	**15,000**	-
Investments	8	**4,477,404**	-
Total assets		**6,100,913**	126,816
LIABILITIES AND PARTNERS' EQUITY			
Current liabilities			
Trade and other payables	9	**131,542**	4,565
Total current liabilities		**131,542**	4,565
Non-current liabilities			
Long-term debt	10	**5,001,239**	-
Deferred revenue	11	**8,000**	-
Class A limited partnership units	12	**133,009**	122,251
Class B limited partnership units	12	**72,979**	-
Total liabilities		**5,346,769**	122,251
Shareholder's and partner's equity			
Share capital	13	**2**	-
Contributed capital	13	**768,417**	-
Reserves		**(12,325)**	-
Deficit		**(1,950)**	-
Total shareholder's and partner's equity		**754,144**	-
Total liabilities and shareholder's and partner's equity		**6,100,913**	126,816

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

For the year ended December 31 (with comparatives for the five months ended December 31, 2012) (thousands of Canadian dollars)	Notes	**2013**	2012
Operating costs		**137**	-
Other income and expense		**1,813**	-
		1,950	-
Loss for the period		**(1,950)**	-
Other comprehensive loss for the period		**(12,325)**	-
Total comprehensive loss for the period		**(14,275)**	-

See accompanying notes

LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENTS OF CHANGES IN PARTNERS' EQUITY

(thousands of Canadian dollars)	Notes	Share Capital	Contributed Capital	Reserves	Allocation to Class A Limited Partner	Allocation to Class B Limited Partner	Deficit	**Total**
Balance at January 1, 2013 and January 1, 2012		-	-	-	-	-	-	**-**
Loss for the period		-	-	-	(37)	(25)	(1,888)	**(1,950)**
Change in fair value of cash flow hedges			-	(12,325)	-	-	-	**(12,325)**
Total comprehensive loss for the period		-	-	(12,325)	(37)	(25)	(1,888)	**(14,275)**
Issuance of share capital		2	-	-	-	-	-	**2**
Capital contributions		-	768,417	-	-	-	-	**768,417**
Balance at December 31, 2013		2	768,417	(12,325)	(37)	(25)	(1,888)	**754,144**

See accompanying notes

LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENTS OF CASH FLOWS

For the year ended December 31 (with comparatives for the five months ended December 31, 2012) (thousands of Canadian dollars)	Notes	**2013**	2012
Cash provided by (used in)			
Operating activities			
Loss for the period		**(1,950)**	-
Adjusted for items not involving a cash flow:			
Change in fair value of cash flow hedges		**1,813**	-
		(137)	
Changes in non-cash working capital balances	19	**122,771**	4,565
Net cash from operating activities		**122,634**	4,565
Investing activities			
Net additions to property, plant and equipment	6	**(194,778)**	(4,565)
Increase in investments	8	**(4,477,404)**	-
Net cash used in investing activities		**(4,672,182)**	(4,565)
Financing activities			
Issue of long-term debt	10	**5,001,239**	-
Issue of Class B limited partnership units	12	**67,731**	-
Increase in restricted cash	5	**(525,472)**	-
Increase in deferred revenue	11	**8,000**	-
Issuance of share capital		**2**	-
Net cash from financing activities		**4,551,500**	-
Net increase in cash		**1,952**	-
Cash and cash equivalents at beginning of period		**-**	-
Cash and cash equivalents at end of period		**1,952**	-

Supplementary cash flow information (Note 19)

See accompanying notes

1. NATURE AND DESCRIPTION OF THE PROJECT

These combined financial statements include the historical financial information of the Labrador Island Link Limited Partnership (LIL LP), Muskrat Falls Corporation (Muskrat Falls), Labrador Transmission Corporation (Labrador Transco), Lower Churchill Management Corporation (LCMC) as well as the LIL Construction Project Trust (Project Trust), The Project Trust is a structured entity created for the purpose of obtaining financing and lending the proceeds to LIL LP. Collectively, the financial information from these combined companies is referred to as the Lower Churchill Project Companies (the Project).

Each of the entities was separately formed under the laws of the Province of Newfoundland and Labrador. LIL LP was formed on July 31, 2012, whereas Muskrat Falls, Labrador Transco and LCMC were formed November 13, 2013. As such, the comparative information for the first set of annual combined financial statements for the Project only reflects those of LIL LP.

The Project was established to carry on the business of designing, engineering, constructing, commissioning, owning, financing, operating and maintaining the assets and property constituting the Labrador-Island Link (the LIL), the Labrador Transmission Assets (the LTA) and the Muskrat Falls (MF) hydro-electric plant .

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance and Basis of Measurement

These annual combined financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The Project has adopted accounting policies which are based on the IFRS applicable as at December 31, 2013, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee (IFRIC) and the former Standing Interpretations Committee (SIC).

These combined financial statements have been prepared on a historical cost basis. The annual combined financial statements are presented in Canadian dollars and all values rounded to the nearest thousands, except when otherwise noted.

The combined financial statements reflect the financial position and financial performance of the Project and do not include other assets, liabilities, revenues, and expenses of the partners of the LIL LP.

These combined financial statements were approved by the Nalcor Board of Directors on DATE 2014.

2.2 Basis of Combination

These combined financial statements include the financial statements of the LIL LP, Muskrat Falls, Labrador Transco, LCMC as well as the Project Trust.

The Project includes the financial statements of investees (including structured entities) only when it has control as defined in IFRS 10 – Combined Financial Statements (IFRS 10). In accordance with IFRS 10, control is achieved when the Project:

- has power over the relevant activities of the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect those variable returns.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.2 Basis of Combination (cont'd.)

Based on the criteria outlined in IFRS 10, the Project has determined that the LIL LP controls the Project Trust for financial reporting purposes. The Project Trust is a structured entity created for the purpose of obtaining financing and lending the proceeds to LIL LP. The LIL LP uses judgement in assessing many factors to determine control of the Project Trust, including its exposure to variability in the Project Trusts' investments and its role in the formation of the Project Trust. The Project has determined that Muskrat Falls and Labrador Transco are not the primary beneficiaries of the Muskrat Falls/Labrador Transmission Assets (MF/LTA) Funding Trust and that the LIL LP does not control the Labrador-Island Link (LIL) Funding Trust and has not included the results of the Funding Trusts in these combined financial statements.

2.3 Cash and Cash Equivalents

Cash and cash equivalents consist of Government of Canada Treasury Bills, Bankers' Acceptances and Term Deposits drawn on Schedule 1 Canadian Chartered Banks. 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 twelve months are classified as short-term investments. Cash and cash equivalents are recorded at cost while short-term investments are measured at fair value.

2.4 Trade and Other Receivables

Trade and other receivables are classified as 'loans and receivables' and are measured at amortized cost using the effective interest method.

2.5 Property, Plant and Equipment

Items of property, plant and equipment are recognized using the cost model and thus are recorded at cost less accumulated depreciation and accumulated impairment losses, if any. Cost includes materials, labour, contracted services, professional fees and finance costs capitalized in accordance with the Project's borrowing costs policy outlined in Note 2.6. Costs capitalized with the related asset include all those costs directly attributable to bringing the asset into operation.

Property, plant and equipment are not depreciated until assets are substantially complete and ready for their intended use

2.6 Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they were incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.7 Impairment of Non-Financial Assets

At the end of each reporting period, the Project reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

2.8 Provisions

A provision is a liability of uncertain timing or amount. A provision is recognized if the Project has a present legal obligation or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. The provision is measured at the present value of the best estimate of the expenditures expected to be required to settle the obligation using a discount rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. Provisions are re-measured at each statement of financial position date using the current discount rate.

2.9 Net Finance Income and Costs

For all financial instruments measured at amortized cost, interest income or expense is recorded using the effective interest rate, which is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability.

2.10 Foreign Currencies

Transactions in currencies other than the Project's functional currency (foreign currencies), which is Canadian dollars, are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Foreign exchange gains and losses are included in profit or loss for the year as finance costs.

2.11 Income Taxes

No provision is made in the accompanying combined financial statements for Canadian federal, provincial, or local taxes since any such liabilities are the responsibility of the individual partners and not that of the Project.

2.12 Financial Instruments

Financial assets and financial liabilities are recognized in the statements of financial position when the Project becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Financial instruments are classified into the following specified categories: financial assets 'at fair value through profit or loss' (FVTPL), financial liabilities FVTPL, 'held-to-maturity' investments, 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.12 Financial Instruments (cont'd.)

Classification of Financial Instruments

The Project has classified each of its financial instruments into the following categories: financial assets at FVTPL; loans and receivables; held to maturity investments; AFS financial assets; financial liabilities at FVTPL; and other financial liabilities.

Cash and cash equivalents	Loans and receivables
Restricted cash	Loans and receivables
Trade and other receivables	Loans and receivables
Investments	Held to maturity investments
Trade and other payables	Other financial liabilities
Long-term debt	Other financial liabilities
Partnership unit liabilities	Other financial liabilities

Financial Assets

(i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a debt instrument and allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income is recognized on an effective interest basis for debt instruments other than those financial assets classified as at FVTPL.

(ii) Financial Assets at FVTPL

Financial assets are classified as at FVTPL when the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that the Project manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.12 Financial Instruments (cont'd.)

Financial Assets (cont'd.)

(ii) Financial Assets at FVTPL (cont'd.)

- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Project's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or

- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments:

  - Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in profit or loss. The net gain or loss recognized in profit or loss incorporates any dividend or interest earned.

(iii) Held-to-Maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Project has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

(iv) AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as available for sale or are not classified in any of the previous categories. Gains and losses arising from changes in fair value are recognized in other comprehensive income (reserves) and accumulated in the fair value reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the fair value reserve is reclassified to profit or loss.

(v) Loans and Receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Financial Liabilities and Equity Instruments

(vi) Classification as Debt or Equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.12 Financial Instruments (cont'd.)

Financial Liabilities and Equity Instruments (cont'd.)

(vii) Financial Liabilities at FVTPL

A financial liability may be classified as at FVTPL if the contracted liability contains one or more embedded derivatives, and if the embedded derivative(s) significantly modify the cash flows or is (are) not closely related to the host liability.

(viii) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

2.13 Derecognition of Financial Instruments

The Project derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Project neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and an associated liability for amounts it may have to pay is recognized. If the Project retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received. The Project derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

2.14 Impairment of Financial Assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Project's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

2.14 Impairment of Financial Assets (cont'd.)

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

2.15 Derivative Instruments and Hedging Activities

Derivative instruments are used by The Project to manage risk. The Project's policy is not to utilize derivative instruments for speculative purposes. The Project may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between the price movements in the derivative instruments and the hedged items. As at December 31, 2013, Muskrat Falls is the only entity within the Project engaged in hedging activities. Muskrat Falls formally documents all hedges and the related risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of these combined financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses including, but not limited to, allocations of costs among entities. Actual results may materially differ from these estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the revision and future periods if the revision affects both current and future periods.

3.1 Use of Estimates and Judgements

<u>Partnership Unit Liabilities</u>
The Partnership Unit Liabilities are exclusive to the LIL LP. The LIL LP determines the fair value of the Limited A and Limited B units at each financial reporting date. These units represent the limited partners' ownership interest in the LIL LP. Due to the nature of the liabilities and lack of comparable market data, the fair value of the Limited A and Limited B units is determined using the present value of future cash flows. Significant assumptions used in the determination of fair value include estimates of the amount and timing of future cash flows and the discount rate.

The process of valuing financial liabilities for which no published market price exists is based on inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the liability. These differences could be material to the fair value of the financial liability.

<u>Consolidation of Structured Entities</u>
Management applies its judgment when determining whether to consolidate structured entities in accordance with the criteria outlined in IFRS 10. Management has determined that the Project should combine the Project Trust but not either of the Funding Trusts.

4. FUTURE CHANGES IN ACCOUNTING POLICIES

The Project has not applied the following new and revised IFRSs that have been issued but are not yet effective:

IFRS 9	Financial Instruments[2]
Amendments to IFRS 9 and IFRS 7	Mandatory Effective Date of IFRS 9 and Transition Disclosures[2]
Amendments to IAS 32	Offsetting Financial Assets and Financial Liabilities[1]

[1] Effective for annual periods beginning on or after January 1, 2014, with earlier application permitted.
[2] Tentatively effective for annual period beginning on or after January 1, 2018.

4.1 IFRS 9 - Financial Instruments and IFRS 7 – Financial Instruments: Disclosures

IFRS 9, issued in November 2009, introduced new requirements for the classification and measurement of financial assets. IFRS 9 was amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition.

Key requirements of IFRS 9 are described as follows:

- All recognized financial assets that are within the scope of IAS 39 are to be subsequently measured at amortized cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income (loss), with only dividend income generally recognized in profit or loss.

- With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability, that is attributable to changes in the credit risk of that liability, is presented in other comprehensive income (loss), unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income (loss) would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss was presented in profit or loss.

As a result of changes to IFRS 9, amendments were also made to IFRS 7 regarding classification of financial instruments for disclosure purposes.

4.2 Amendments to IAS 32

The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realization and settlement'.

Management continues to assess the impact of these standards that are issued but not yet effective.

5. CASH AND CASH EQUIVALENTS

As at December 31, 2013, cash and cash equivalents consist entirely of cash.

Restricted cash is held in accounts administered by a collateral agent for the sole purpose of funding construction costs related to the Project. The Project draws funds from these accounts on a monthly basis in accordance with procedures set out in the Labrador-Island Link Project Finance Agreement (LIL PFA) and the Muskrat Falls/Labrador Transmission Asset Project Finance Agreement (MF/LTA PFA).

6. PROPERTY, PLANT AND EQUIPMENT

Capitalized costs related to the construction of the LIL, Muskrat Falls hydro-electric facility and Labrador Transmission Assets for the periods ended 2012 and 2013 are shown in the table below:

(thousands of Canadian dollars)	Construction in Progress
Cost	
Balance at July 31, 2012	-
Contributions	121,380
Additions	5,436
Balance at December 31, 2012	126,816
Contributions	**739,279**
Additions	**210,784**
Balance at December 31, 2013	**1,076,879**

As at December 31, 2013, all amounts recorded in construction in progress relate to the development of the LIL, LTA and the MF hydro-electric facility.

On November 30, 2012, Nalcor contributed construction in progress with a fair value of $883.8 million to the Project.

<u>Capitalized Borrowing Costs</u>
The construction of the LIL, LTA and MF hydro-electric facility was sanctioned in December 2012 and is expected to take several years to complete. The construction is being financed, in part, through the issuance of long-term debt. During 2013, $5.7 million of borrowing costs associated with long-term debt were capitalized. The effective interest rate of the debt is 3.80% to 3.83%. The Project capitalized borrowing costs associated with the Limited A units and Limited B units of $16.0 million (2012 - $0.9 million) as non-cash additions to property, plant and equipment.

7. ADVANCES

Advances consist of deposits paid to contractors on long-term construction contracts in relation to the MF hydro-electric facility.

8. INVESTMENTS

In December 2013 the Project purchased three structured deposit notes using the proceeds from the issue of long-term debt.

Details on the investments are as follows:

(thousands of Canadian Dollars)	**2013**	2012
Two $75.0 million Floating Rate Deposit Notes, with interest paid at the one-month Canadian Dealer Offer Rate (CDOR) plus 0.38%.	**150,000**	-
$883.5 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.38%.	**879,369**	-
$1,325.3 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.6182% per annum	**1,319,052**	-
$478.2 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.38%.	**425,796**	-
$1,912.7 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.5937% per annum	**1,703,187**	-
	4,477,404	-

9. TRADE AND OTHER PAYABLES

The composition of trade and other payables is as follows:

(thousands of Canadian dollars)	**2013**	2012
Trade payables	**119,733**	-
Accrued interest	**9,217**	-
Related party payables	**1,546**	4,565
Other payables	**1,046**	-
	131,542	4,565

10. LONG-TERM DEBT

Details of long-term debt are as follows:

(millions of Canadian dollars)	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	**2013**	2012
LIL LP						
Tranche A	725,000	3.76	2013	2033	**725,304**	-
Tranche B	600,000	3.86	2013	2045	**600,114**	-
Tranche C	1,075,000	3.85	2013	2053	**1,075,225**	-
Muskrat Falls/Labrador Transco						
Tranche A	650,000	3.63	2013	2029	**650,234**	-
Tranche B	675,000	3.83	2013	2037	**675,107**	-
Tranche C	1,275,000	3.86	2013	2048	**1,275,255**	-
Total debentures	5,000,000				**5,001,239**	-

On November 29, 2013, the Project Trust entered into the IT Project Finance Agreement (IT PFA) with the Labrador-Island Link Funding Trust (LIL Funding Trust). Under the terms and conditions of the IT PFA, the LIL Funding Trust agreed to provide a non-revolving credit facility (LIL Construction Facility) in the amount of $2.4 billion available in three tranches (Tranches A, B and C) to the LIL LP. The purpose of the LIL Funding Trust is to issue long-term debentures to the public, which debt is guaranteed by the Government of Canada and to on-lend the proceeds to the Project Trust. The proceeds of the facility are to be used exclusively for the construction of the LIL.

On December 13, 2013, all three tranches of the LIL Construction Facility where drawn down by way of a single advance to the Project Trust of $2.4 billion. Under the terms of the IT PFA, the $2.4 billion advance is held in an account administered by a collateral agent with a portion of the funds invested in structured deposits notes. The LIL LP draws funds from this account on a monthly basis in accordance with procedures set out in the LIL PFA.

The role of the collateral agent is to act on behalf of the lending parties, including the LIL Funding Trust and the Government of Canada. The collateral agent oversees the lending and security arrangements, the various project accounts and the compliance with covenants.

As security for these debt obligations, the LIL LP has granted to the collateral agent first ranking liens on all present and future assets. On the date of the release of the final funding request from the collateral agent, sinking funds are required to be set up for each of the three tranches to be held in a sinking fund account administered by the collateral agent.

On November 29, 2013, Muskrat Falls and Labrador Transco entered into the MF/LTA PFA with the Muskrat Falls/Labrador Transmission Assets Funding Trust (MF/LTA Funding Trust). Under the terms and conditions of the MF/LTA PFA, the MF/LTA Funding Trust agreed to provide a non-revolving credit facility (MF/LTA Construction Facility) in the amount of $2.6 billion available in three tranches (Tranches A, B and C). The purpose of the MF/LTA Funding Trust is to issue long-term debentures to the public, which debt is guaranteed by the Government of Canada and to on-lend the proceeds to Muskrat Falls and Labrador Transco. Muskrat Falls and the Transco are both jointly and severally liable for the full amount of the credit facility.

10. LONG-TERM DEBT (cont'd.)

On December 13, 2013, all three tranches of the MF/LTA Construction Facility were drawn down by way of a single advance of $2.6 billion. Under the terms of the MF/LTA PFA, the $2.6 billion advance is held in an account administered by the collateral agent with a portion of the funds invested in structured deposits notes. Muskrat Falls and Labrador Transco draw funds from this account on a monthly basis in accordance with procedures set out in the PFA. Muskrat Falls' portion of the drawings under the facility totals $2.1 billion and is to be used exclusively for the construction of the MF hydro-electric facility. Labrador Transco's portion of the drawings under the facility totals $0.5 billion and is to be used exclusively for the construction of the LTA.

The role of the collateral agent is to act on behalf of the lending parties, including the MF/LTA Funding Trust and the Government of Canada. The collateral agent oversees the lending and security arrangements, the various project accounts and the compliance with covenants.

As security for these debt obligations, Muskrat Falls and Labrador Transco have granted to the collateral agent first ranking liens on all present and future assets. On the date of the release of the final funding requests from the collateral agent, sinking funds are required to be set up for each of the three tranches to be held in an account administered by the collateral agent.

11. DEFERRED REVENUE

If certain predefined terms are met, Labrador-Island Link Operating Corporation (LIL Opco) may be required to prepay rent in accordance with the LIL Lease Agreement. For the year ended December 31, 2013, LIL Opco paid $8.0 million to the Project. The Project has recognized these prepayments as deferred revenue which will be amortized to income once the LIL is in-service.

12. PARTNERSHIP UNIT LIABILITIES

Debt and equity instruments issued by LIL LP are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

The LIL LP has four classes of units; Class A, Class B, Class C and the General Partner unit. The Class A and B unit holders and the General Partner are each entitled to voting rights, mandatory distributions and allocations of profit and loss as provided by the terms of the LIL Limited Partnership Agreement. The Class C unit holder is not entitled to voting rights, distributions or allocations of profit and loss, but may share in the remaining assets of the LIL LP in a liquidation after full recovery of the outstanding capital accounts of the Limited A and Limited B units.

12.1 Description of the Class A and Class B Limited Partnership Unit Liabilities

Limited A units and Limited B units issued to the limited partners represent LIL Holdco's and Emera NL's interests in the LIL LP, respectively. The Limited A units and Limited B units have certain rights and obligations, including mandatory distributions, that result in the classification of these units as liabilities. The partnership units are measured at amortized cost using the effective interest method. The return on the units is classified as a finance expense. All finance expenses associated with the Limited A and Limited B units have been capitalized.

12. PARTNERSHIP UNIT LIABILITIES (cont'd.)

12.2 Class A Limited Partnership Unit Liabilities

In 2012, the Limited A units were issued as consideration for LIL assets the LIL LP received from LIL Holdco. The components of the change in balances in the Limited A units are as follows:

(thousands of Canadian dollars)	**Units**	**2013**	Units	2012
Class A limited Partnership unit liabilities at beginning of period	**75**	**122,251**	-	-
Units issued	**-**	**-**	75	121,380
Accrued interest		**10,758**		871
Class A limited Partnership unit liabilities at end of period	**75**	**133,009**	75	122,251

12.3 Class B Limited Partnership Unit Liabilities

In 2013, the Limited B units were issued as considerations for cash contributed by Emera NL. The components of the change in balances in the Limited B units are as follows:

(thousands of Canadian dollars)	**Units**	**2013**	Units	2012
Class B limited Partnership unit liabilities at beginning of period	**-**	**-**	-	-
Units issued	**25**	**67,731**	-	-
Accrued interest		**5,248**		-
Class B limited Partnership unit liabilities at end of period	**25**	**72,979**	-	-

13. SHAREHOLDER'S EQUITY

13.1 Issued Capital

The issued capital of the Project as at December 31, 2013 is summarized below:

(thousands of Canadian dollars)	**2013**	2012
Share capital		
Authorized – unlimited		
Issued, fully paid and outstanding – 200	**2**	-

13.2 Shareholder Contributions

(thousands of Canadian dollars)	**2013**	2012
Contributed capital	**768,417**	-

During 2013, Nalcor made cash contributions to Muskrat Falls totaling $14.1 million. Nalcor also contributed property, plant and equipment to Muskrat Falls and Labrador Transco in the amount of $762.4 million and associated advances of $15.0 million and liabilities of $23.1 million.

14. NET FINANCE INCOME AND COSTS

(thousands of Canadian dollars)	2013	2012
Finance income		
Interest on investments	**2,252**	-
Other interest income	**1,286**	-
	3,538	-
Finance costs		
Interest on Partnership unit liabilities	**(16,006)**	-
Interest on long-term debt	**(9,217)**	-
	(25,223)	-
Interest capitalized during construction	**21,685**	-
Net finance costs	**-**	-

15. CAPITAL MANAGEMENT

The capital structure of the Project is comprised of share capital, contributed capital net of deficit, partner capital (issued units, cash calls and retained earnings) and long-term debt. The capital structure is adjusted through the amount of distributions paid to the Partners as well as capital contributions.

The Project's objectives for managing capital are to maintain its ability to continue as a going concern, to fund the construction of its assets while providing its partners the required return, and to ensure timely payment of its contractual obligations as they relate to the construction of the LIL, LTA and MF hydro-electric facility.

The Project's requirements for capital are expected to increase commensurate with progress on construction. During this time, it is expected that proceeds from the Construction Facilities and contributed capital will be sufficient to fund the development of the assets. Additional requirements will be funded entirely through contributed capital. Nalcor Energy, as well as the Province of Newfoundland and Labrador have provided guarantees of equity support in relation to the construction of the Project. These guarantees, together with the proceeds from long-term debt, will ensure sufficient funds are available to finance construction.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

16.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2013 and 2012 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that the Project might receive or incur in actual market transactions.

As a significant number of the Project's assets and liabilities do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of the Project as a whole.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

16.1 Fair Value

Establishing Fair Value
Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
(thousands of Canadian dollars)		**2013**		2012	
Financial assets					
Cash and cash equivalents	1	**1,952**	**1,952**	-	-
Restricted cash	1	**525,472**	**525,472**	-	-
Other receivables	1	**2,967**	**2,967**	-	-
Investments	2	**4,477,404**	**4,476,229**	-	-
Financial liabilities					
Trade and other payables	1	**131,542**	**131,542**	4,565	4,565
Long-term debt	2	**5,001,239**	**4,991,121**	-	-
Class A limited partnership units	3	**133,009**	**133,009**	122,251	122,251
Class B limited partnership units	3	**72,979**	**72,979**	-	-

The fair value of cash and cash equivalents, restricted cash, trade and other receivables and trade and other payables approximate their carrying values due to their short-term maturity.

The table below sets forth a summary of changes in fair value of the Project's level 3 financial liabilities given a one percent change in the discount rate applied to the future cash flows:

(thousands of Canadian dollars)	1% increase in discount rate	1% decrease in discount rate
Limited A units	(29,600)	35,500
Limited B units	(36,000)	44,200
Total	(65,600)	79,700

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Cont'd)

16.2 Financial Risk Management

The Project is exposed to credit, liquidity and market risks through its operating, investing and financing activities.

(a) Credit Risk

The Project's expected future cash flows are exposed to credit risk through financing activities, based on the risk of non-performance by counterparties to financial instruments.

Credit risk on cash and cash equivalents, restricted cash and investments is minimal, as the Project's deposits are held by Canadian Schedule 1 Chartered Banks with ratings of A+ and AA- (Standard and Poor's).

(b) Liquidity Risk

The Project is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Activities around liquidity risk management are directed at ensuring cash is available to meet those obligations as they become due. Short-term liquidity is provided through cash and cash equivalents on hand. The Project can access the funds drawn down from the LIL Construction Facility and equity contributions for the payment of construction costs as well as interest payments.

The following are the contractual maturities of the Project's financial liabilities, including principal and interest, as at December 31, 2013:

(thousands of Canadian dollars)	< 1 Year	1-3 Years	3-5 Years	> 5 Years	Total
Trade and other payables	132,879	-	-	-	132,879
Long-term debt (including interest)	189,470	380,941	380,941	9,655,861	10,607,213
Unit A partnership units	-	-	2,630	130,379	133,009
Unit B Project partnership units	-	-	4,425	68,554	72,979
	322,349	380,941	387,996	9,854,794	10,946,080

(c) Market Risk

The Project is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities.

Interest Rates
Changes in prevailing interest rates will impact the fair value of financial assets and liabilities. Expected future cash flows from these assets and liabilities are also impacted in certain circumstances. The following table illustrates the Project's exposure to a 50 basis point (bps) change in interest rates:

	Profit	
(thousands of Canadian dollars)	50 bps Decrease	50 bps Increase
Interest on investments	(223)	223

Throughout December 2013, Muskrat Falls entered into a series of nine bond forward rate agreements with a notional value of $2.0 billion to mitigate interest rate exposure on the impending long-term debt issuance. These contracts provided Muskrat Falls with an average yield on the underlying Government of Canada 4.0% Bonds (maturing June 1, 2041) of 3.2547%.

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Cont'd)

16.2 Financial Risk Management (cont'd.)

(c) Market Risk (cont'd.)

Foreign Currency and Commodity Exposure
The Project does not hold any financial instrument whose value would vary due to changes in a commodity price or fluctuations in foreign currency exchange rates. Cash flow exposure to commodity price and foreign exchange risk arises primarily through investing activities, most notably US dollar and Euro denominated capital expenditures, and regular procurement activities. Exposure arising from capital expenditures is evaluated on a case by case basis. Where possible, contacts are denominated in Canadian dollars.

16.3 Hedge Accounting

In December 2013, Muskrat Falls entered into nine bond forward contracts totaling $2.0 billion to hedge the interest rate risk on the forecasted issue of long-term debt. These contracts were designated as part of a cash flow hedging relationship and the resulting change in fair value of $14.1 million was recorded $12.3 million in other comprehensive income (loss) with $1.8 million of ineffectiveness recognized immediately in other income and expense. The loss will be recognized in profit or loss over the same period as the related debt instruments which mature between 2029 and 2048.

17. RELATED PARTY TRANSACTIONS

The Project enters into various transactions with its parents, subsidiary and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which the Project transacts are as follows:

Related Party	Relationship
LIL Holdco	Limited Partner holding 75 Class A limited partnership units of LIL LP
Emera NL	Limited Partner holding 25 Class B limited partnership units of LIL LP
Nalcor	100% shareholder of LIL Holdco, Labrador Transco, LCMC, LIL Opco, LIL GP and Muskrat Falls
LIL Opco	Wholly- owned subsidiary of Nalcor Energy
LIL GP	General partner of LIL LP, wholly-owned subsidiary of Nalcor
LIL Funding Trust	Party to the IT PFA
Hydro	Wholly-owned subsidiary of Nalcor
MF/LTA Funding Trust	Party to the MF/LTA Project Finance Agreement

(a) In its normal course of opreations, The Project receives engineering, technical, management and administrative services from Nalcor. As at December 31, 2013, Labrador Transco had intercompany payanbles owing to Nalcor of $5.0 million which is recorded as part of trade payables.

(b) In February 2013, Emera NL contributed $67.7 million in exchange for 25 Class B partnership units.

(c) For the year ended December 31, 2013, LIL Opco prepaid rent in the amount of $8.0 million (2012 - $nil).

(d) In November 2012, Nalcor contributed construction in progress to the LIL LP with a fair value of $121.4 million.

(e) In November 2013, Nalcor contributed construction in progress of $653.5 million together with advances of $15.0 million and liabilities of $21.8 million which resulted in a net contribution of capital of $646.7 million. In December 2013, Nalcor also contributed cash of $14.1 million.

17. RELATED PARTY TRANSACTIONS (cont'd.)

(f) On November 30, 2013, Nalcor contributed construction in progress to Labrador Transco of $108.9 million along with liabilities of $1.3 million which resulted in a net contribution of capital of $107.6 million.

18. COMMITMENTS AND CONTINGENCIES

(a) LIL LP is required to make mandatory distributions in accordance with the Partnership Agreement. The amount of periodic distributions will be determined by the General Partner and will commence once construction of the LIL is complete.

(b) As part of the IT PFA, LIL LP has pledged its current and future assets as security to the collateral agent. Under the terms and conditions of the IT PFA, LIL LP has also provided a guarantee of the Project Trust's payment obligations to the collateral agent for the benefit of the Funding Trust.

(c) Labrador Transco and Muskrat Falls have entered into the GIA with Newfoundland and Labrador Hydro (Hydro), whereby Labrador Transco has committed to design, construct, operate and maintain the Labrador Transmission Assets and Muskrat Falls is liable to pay for these costs. Under the terms of the Power Purchase Agreement (PPA), Muskrat Falls will recover all costs associated with the Labrador Transmission Assets from Hydro.

(d) As part of the PFA, Labrador Transco and Muskrat Falls have pledged their present and future assets as security to the collateral agent. As part of the PPA arrangement with Hydro, Muskrat Falls has provided subordinated security in the Muskrat Falls hydro-electric facility to Hydro.

(e) As at December 31, 2013, the LIL LP had outstanding commitments for construction costs related to the LIL of $296.1 million, Labrador Transco had outstanding commitments for construction costs related to the LTA of $337.8 million and Muskrat Falls had outstanding commitments for construction costs related to the Muskrat Falls hydro-electric facility of $1.6 billion.

(f) Muskrat Falls has entered into a PPA with Hydro whereby Muskrat Falls has committed to design, construct, operate and maintain the Muskrat Falls hydro-electric facility, and deliver energy as scheduled by Hydro under the terms of the PPA.

(g) The Project is subject to legal proceedings in the normal course of business. Although the outcome of such actions cannot be predicted with certainty, Management currently believes The Project's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be nil.

19. SUPPLEMENTARY CASH FLOW INFORMATION

(thousands of Canadian dollars)	**2013**	2012
Other receivables	**(2,967)**	-
Prepayments	**(1,239)**	-
Trade and other payables	**126,977**	4,565
Changes in non-cash working capital balances	**122,771**	4,565