



October 21, 1997

Mr. Guy Chevette
Minister of State for Natural Resources
Édifce de l'Atrium
5700, 4^e Avenue ouest, bureau A-308
Charlesbourg (Québec)
G1H 6R1

Dear Sir:

We are pleased to submit Hydro-Québec's *Strategic Plan 1998-2002*.

The Plan presents a profile of the company, as well as the major trends emerging in its business environment. It is intended to identify the forces operating on the Québec, North American, and international markets as the company embarks on a period of sustained growth and profitability.

The Plan focuses on the growth and profitability strategies that will pave the way for Hydro-Québec to achieve significant gains and greater profitability. To reach its objectives, the company can count on a qualified work force whose expertise and know-how are internationally renowned. A great number of our employees have contributed to the development of this Plan. They, like senior management and the Board of Directors, are preparing to face the challenges of the coming years, working together to ensure that Hydro-Québec can continue to offer energy rates that rank among the lowest in North America, while meeting its customers' needs.

As world markets open up, Hydro-Québec is fully aware of the role it plays in the Québec economy, and of its social and environmental responsibilities as a "business first" publicly owned company.

Yours very truly,

A handwritten signature in black ink, appearing to read 'L. Jacques Ménard'.

L. JACQUES MÉNARD
Chairman of the Board

A handwritten signature in black ink, appearing to read 'André Caillé'.

ANDRÉ CAILLÉ
President and Chief Executive Officer

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In July 1997, the Québec government amended the order-in-council regarding Hydro-Québec's Strategic Plan. The *Strategic Plan 1998-2002* must be submitted to the government on or before November 1, 1997. It will be subject to review by a parliamentary commission of the National Assembly within three months following the date on which it was tabled.

Note to the reader — Unless otherwise indicated, monetary amounts in the text are expressed in Canadian dollars (\$) and cents (¢).

Summary

The electricity industry worldwide is going through a period of profound change.

This is particularly evident in the United States, where the industry is undergoing its most extensive restructuring since the *New Deal* era of the 1930s.

In Québec, the wholesale market and the electricity transmission system have been open to third parties since May 1, 1997, and a new regulatory framework has been introduced under the new Energy Policy. This policy calls on Hydro-Québec to become the cornerstone of an industrial strategy aimed at making Québec a major energy hub.

Elsewhere in Canada, major restructuring measures have been adopted in British Columbia and Alberta, and Ontario recently announced it may soon follow suit.

On the international stage, the demand for energy is expected to show strong growth over the next 10 years, translating into massive investments to build the requisite infrastructure.

It is within this general context, and in an effort to best serve the interests of its customers, shareholder, employees and partners, that Hydro-Québec has established its orientations for the 1998-2002 period.

Corporate Orientations 1998-2002

Hydro-Québec's orientations for the 1998-2002 period and their related objectives stem from a desire for sustained growth, profitability, and continuity.

These orientations reflect the business opportunities open to Hydro-Québec given its traditional activities in Québec, the restructuring of North American energy markets, and the emergence of Québec as a major energy hub.

These business opportunities flow from the:

- growing demand for electricity in Québec;
- opening of markets peripheral to Québec;
- profitable investment outlook in hydroelectric generation and electricity transmission;
- growth potential arising from the convergence of various forms of energy;
- other business opportunities that are complementary to the company's current activities and services; and from
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- growing energy requirements on international markets.

Hydro-Québec has a number of major advantages that position it well to seize these opportunities:

- hydroelectric potential that can be developed at costs as competitive as its existing production costs;
- access to attractive markets peripheral to Québec;
- employees with the necessary expertise and know-how;
- strong financial capability;
- financing costs that have rarely been as attractive as today, given current low interest rates and the shrinking of yield spreads between Hydro-Québec bonds and those of Ontario Hydro and the Government of Canada;
- a high-quality network of industrial alliances; plus
- a worldwide reputation.

Given these competitive advantages, Hydro-Québec, as a public company, is determined to manage on a “business first” basis, convinced this will enable it to become a more effective driving force in Québec’s economic development. Hydro-Québec has therefore adopted five major orientations for the 1998-2002 period. These orientations are indivisible, since the objectives tied to one cannot be achieved unless the objectives related to all the others are achieved.

1. Maintain rates and service quality in Québec

Hydro-Québec plans to build on its achievements. This orientation reiterates Québec’s social pact based on the benefits flowing from the nationalization of electricity, namely, low rates, particularly in the residential sector; uniform rates by customer category throughout the power system; rate stability for all customer categories ensured by hydroelectric generation, and by the public ownership of Hydro-Québec.

The measures taken to implement this orientation include a rate freeze for the period ending April 2002, following an inflation adjustment on May 1, 1998, and the price-based regulation of production.

2. Put Hydro-Québec back on the path to growth and reasonable profitability, while respecting the environment in cooperation with local communities

Hydro-Québec is focusing on growth and profitability. This orientation is based on the opportunity to complete the development of Québec’s hydroelectric potential, in line with the developments of the past 30 years. Before proceeding, new projects will have to meet three conditions: they must be profitable, environmentally acceptable, and well received by local communities.

To realize the full potential of this new production, Hydro-Québec has set a target of 40 TWh in new sales within the next 10 years, a 25% increase in annual sales over 1997. Over the period 1998-2002, Hydro-Québec will achieve 50% of this ten-year objective, representing a 20-TWh increase in annual electricity sales overall, that is, 14 TWh in Québec, and 6 TWh outside Québec.

3. Develop a world-class international activity base

Hydro-Québec intends to expand its growth potential to ensure the continuity of its know-how, expertise and growth, as well as that of the Québec-based electricity industry as a whole, beyond the next 10 years. The company therefore plans to seize potential business opportunities on international markets.

Consequently, Hydro-Québec will invest, through Hydro-Québec International, up to \$1.2 billion abroad as an industrial partner in infrastructure projects related to electricity generation and energy transmission and distribution. Hydro-Québec's approach will rely heavily on technological and commercial partnerships all over the world.

4. Ensure that all employees contribute to Hydro-Québec's development and ensure continuity of know-how

Hydro-Québec intends to rally its employees to achieve its growth and profit objectives. This is a key factor in the success of the *Strategic Plan 1998-2002*. Hydro-Québec is fully cognizant of the central role played by its employees in the company's past, present and future successes.

Hydro-Québec will do its utmost to create a climate of trust within the organization. It will also continue quality-based management, establish a business culture focused on growth and profitability, and develop its human resources in line with the new industry context. In particular, the company plans to stabilize its total work force at around 19,500 employees by the year 2000, and then start hiring new staff according to the needs brought about by natural attrition and business growth.

5. Turn R&D into an instrument of growth and profitability for the company

Hydro-Québec intends to maintain its technological leadership, which is both a source of pride and a springboard for future growth and profitability. The company plans to reap the benefits from the \$100 million it has invested annually in R&D for the past 20 years.

Hydro-Québec aims to meet the R&D needs of its business units, on a self-financed basis, by 2002. The company will also earmark \$20 million annually for prospective and long-term research.

Financial Outlook

Hydro-Québec's proposed growth and profitability strategies for the 1998-2002 period will substantially improve the company's financial situation in general, and most especially its profitability.

Hydro-Québec's consolidated net income is expected to reach \$1.85 billion by 2002, for a return on equity of 11.8%. Based on consolidated results estimates, the company expects to pay more than \$3.3 billion in dividends to its shareholder over the period covered by the *Strategic Plan 1998-2002*.

Investments from 1998 to 2002 will exceed \$13 billion and the level of long-term debt will decline slightly.

Shareholder's equity is expected to rise by more than \$3.2 billion over this period, from \$12.9 billion in 1997 to \$16.1 billion in 2002, bringing the company's capitalization ratio to 31.1% by the end of 2002.

Economic Impact

Besides the net income it generates, and the dividends it pays to its shareholder, the Québec government, Hydro-Québec also contributes to the economic prosperity of Québec through its growth, investments, and purchases.

Over the 1998-2002 period, Hydro-Québec's activities will help sustain jobs equivalent to 194,100 person-years in all regions of Québec.

Chapter 1 Brief History

Hydro-Québec has been serving Quebecers for over 50 years.

In 1944, Québec acquired Montreal Light, Heat & Power Consolidated for the specially created Quebec Hydro-Electric Commission. Hydro-Québec was born. Serving customers mainly in the Montréal area, the new company inherited four generating stations: Chambly, Rivière-des-Prairies, Les Cèdres and Beauharnois.

A period of profound change followed World War II: the population increased year after year, urban development stretched city boundaries, and industrial activity boomed. At the end of the 1950s, these changes intensified and accelerated, and Hydro-Québec had to launch new projects to meet its customers' growing needs.

In the late 1950s, Hydro-Québec started construction on the Manic-Outardes complex, applying the know-how it had acquired over the years, and assisted by Québec engineering consulting firms whose extraordinary achievements would earn them an international reputation.

In 1962, to eliminate rate disparities and the abusive practices of certain suppliers, particularly in outlying or resource-poor regions, the Québec government announced its decision to nationalize the electricity sector in favor of Hydro-Québec.

This brought about dramatic changes. Uniform rates were gradually introduced and service made equally reliable across Québec. Hydro-Québec became a part of daily life for consumers.

Since that time, Hydro-Québec has been able to meet the needs of Quebecers as a whole, guaranteeing the same improved quality of service for all, and formulating a plan to develop electricity sources.

Created in 1967, the Institut de recherche d'Hydro-Québec (IREQ) quickly became a world authority in numerous fields and an international showcase for Québec know-how.



Inaugurated in 1968, the Daniel-Johnson dam at Manic-5 stands as a symbol of Quebecers' ingenuity. The dam is 1.3 km long and reaches a height of 214 m, making it the largest arch and buttress dam in the world. With a capacity of 5,517 MW, the Manic-Outardes complex ensured the availability of low-cost energy.

At the end of the 1960s, Hydro-Québec and Newfoundland & Labrador Hydro became partners in Churchill Falls (Labrador) Corporation to develop the hydroelectric potential of the upper reaches of the Churchill River in Labrador, and a 5,428-MW generating station was built.

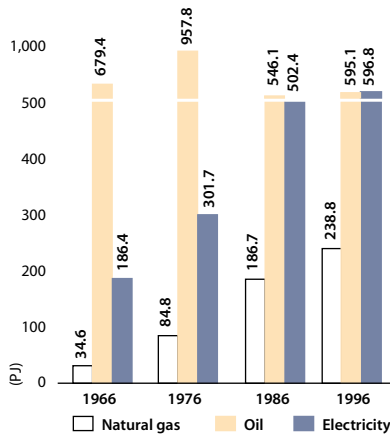
In the early 1970s, the Québec government launched the La Grande hydroelectric complex at James Bay, the largest construction project in the history of Québec. While the project was initially received with skepticism, it started to gain popularity following the 1973 and 1976 oil crises. So many Quebecers were working on the project that it seemed as if the province was one huge construction site.

In 1975, Hydro-Québec, the Cree and Inuit communities, and the governments of Québec and Canada signed the *James Bay and Northern Québec Agreement*, which has since served as a model around the world. Over the years, other agreements have been added to the original document to broaden its scope. Founded on respect, understanding and the sharing of common objectives, these agreements paved the way for new partnerships.

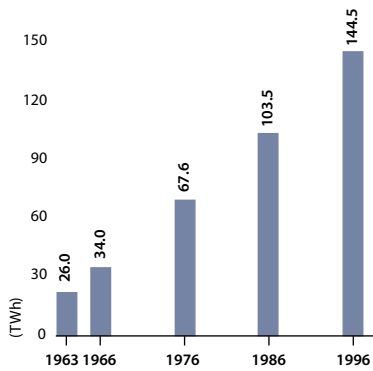
Thanks to the James Bay generating stations, Hydro-Québec was in a position to meet Quebecers' growing needs without difficulty. Electricity gradually took on a larger role in Québec's energy balance, ensuring greater self-sufficiency and a more secure source of power. Throughout this period, electricity was an integral part of Québec's industrial development.

In 1978, Hydro-Québec set up Hydro-Québec International (HQI), a subsidiary created to open doors to new international markets. For many years, HQI was mainly involved in technical assistance, primarily in French-speaking African countries.

Changes in Québec's Energy Balance
Final Energy Consumption (in petajoules — PJ)



Electricity Demand — 1963-1996*



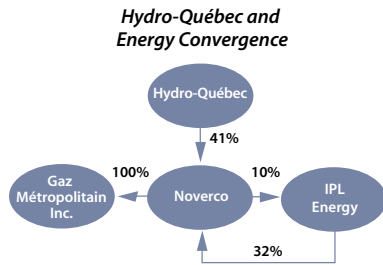
* Data for 1990 to 1996 include the impact of energy-conservation programs.

In the early 1980s, Phase I of the La Grande complex was completed. The Québec National Assembly amended the *Hydro-Québec Act*, authorizing the company to pay an annual dividend to the government and to sell more electricity outside Québec. At the end of the decade, the company announced the start of Phase II of the La Grande complex.

The 1990s have seen the continued development of hydroelectricity, the launching of an ambitious energy-efficiency program, and the achievement of a level of customer service that ranks among the best in the North American industry.

In 1997, spurred by the energy convergence sweeping North American markets, Hydro-Québec acquired a 41% stake in Noverco, the holding company which owns Gaz Métropolitain Inc. The company also acquired an indirect interest in IPL Energy, which operates the world’s longest petroleum pipeline system, and is Canada’s largest natural gas distribution company.

As the new millennium approaches, the competitiveness and stability of its hydroelectric facilities, combined with its technical performance, R&D know-how and the quality of its customer service, position Hydro-Québec well, both as a driving force in Québec’s economic development, and as a “business first” public company serving all Quebecers.



Chapter 2 Business Environment

The electricity industry worldwide is going through a period of profound change.

This is particularly evident in the United States, where the industry is undergoing its most extensive restructuring since the *New Deal* era of the 1930s. One of the key objectives of this restructuring is to stimulate greater competition in electricity generation and to allow consumers to choose their electricity supplier.

Restructuring of the North American Electricity Industry

However, this restructuring is not limited to the United States. In Québec, a new regulatory framework has been introduced under the new Energy Policy. Elsewhere in Canada, major restructuring measures have been adopted in British Columbia and Alberta, and Ontario recently announced it may soon follow suit.

It is within this general context, and in an effort to best serve the interests of its customers, shareholder, employees and partners, that Hydro-Québec must establish its strategic orientations.

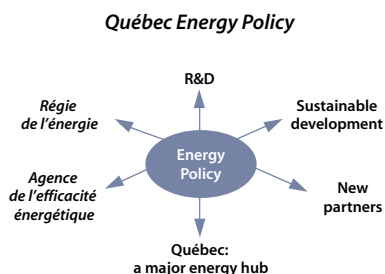
Situation in Québec

After an extensive public debate on energy, in 1996 the Québec government unveiled a new energy policy entitled *Energy at the Service of Québec*.

The policy's objective is to put energy to work for Quebecers, and to respect the principles of sustainable development while taking full advantage of the changes under way in the North American energy industry.

The policy calls on Hydro-Québec to achieve those objectives, and outlines a number of major orientations which concern the company:

- Hydro-Québec shall remain the exclusive property of the Québec government;
- Hydro-Québec shall improve its profit margin and provide a greater return to its shareholder;
- Hydro-Québec shall become the cornerstone of an industrial strategy aimed at making Québec a major energy hub;



- Hydro-Québec shall pursue its R&D efforts while emphasizing the commercial potential of its projects, so as to increase its partnership opportunities with the private sector and generate greater industrial and commercial spin-offs;
- Hydro-Québec shall seek to forge a new economic partnership with aboriginal nations, with a view to developing Northern Québec's energy resources.

Hydro-Québec took these orientations, and the central objective of the Energy Policy, into account in formulating its *Strategic Plan 1998-2002*.

Régie de l'énergie

The Energy Policy also emphasized the need to modernize Québec's energy regulatory framework, which has led to the creation of a new board known as the *Régie de l'énergie*.

In Québec, the *Régie du gaz naturel* had for many years been responsible for the regulation of natural gas distribution. The creation of the *Régie de l'énergie* in December 1996 gave Québec a regulatory board with a broader mandate that encompasses all activities related to energy distribution.

The *Act respecting the Régie de l'énergie* stipulates, among other things, that the generation, transmission, and distribution of electricity are regulated activities. As a result, electricity rates in Québec are subject to the approval of the *Régie de l'énergie*.

Wholesale market

In the world of electricity, as in most other industries, the wholesale market is a market of intermediaries, whether distributors or other types of resellers. In Québec, the wholesale market includes 11 electric power distributors: Hydro-Québec, nine distributors operating municipal systems, and one regional cooperative.

The May 1, 1997 opening of the wholesale market to competition among suppliers introduced a whole new dimension to the structure of the Québec electricity market. On the same date, Hydro-Québec's electricity transmission system was opened for use by third parties, becoming an open-access system.

Québec Electric Power Distributors

- Hydro-Québec
- 9 municipal systems
- 1 regional electricity cooperative

TransÉnergie Customers

(as at October 1, 1997)

Electricity Producers

- Hydro-Québec (Generation)
- James MacLaren Industries

Electricity Distributor or Reseller

- Vermont Public Power
Supply Authority

In practice, this means that, since May 1, 1997, the municipal systems and the regional electricity cooperative have been allowed, like Hydro-Québec, to purchase electricity outside Québec, and Québec independent producers have been permitted, like Hydro-Québec, to sell their electricity outside Québec.

Since then, Hydro-Québec has, through its transmission division, TransÉnergie, concluded two transit agreements for the delivery of electricity outside Québec.

However, there has been no transaction involving outside producers supplying electricity directly to the Québec wholesale market. The low electricity rates in Québec most likely explain this absence of transactions.

Retail market

The retail market includes all electricity consumers — industrial, commercial, institutional, residential and farm.

The opening of the retail market to competition is a key element in the restructuring of American markets, particularly in regions with high electricity rates, such as California and the Northeastern U.S.

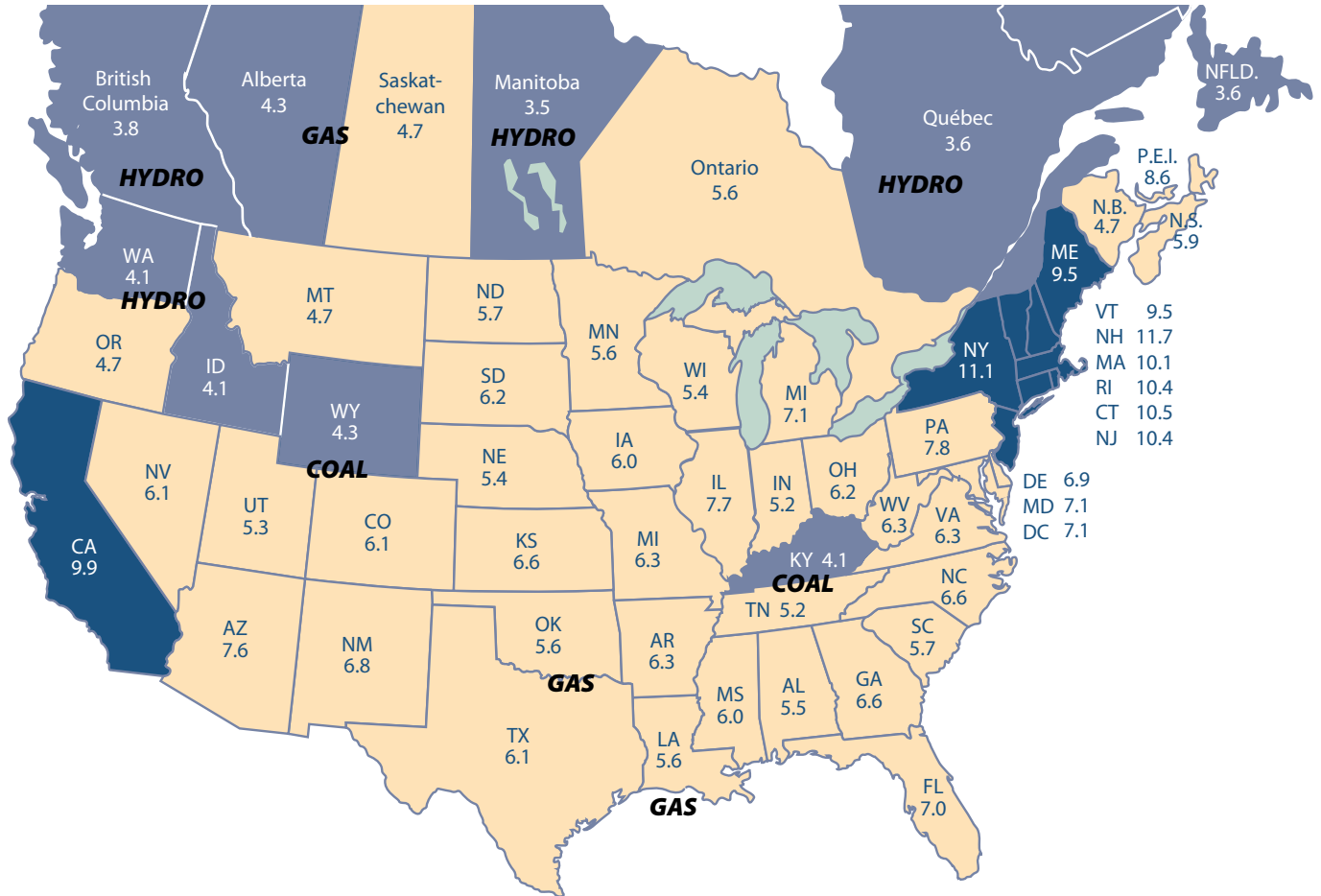
Conversely, Québec's low electricity rates and the presence of a very large and competitive hydroelectric producer, Hydro-Québec, make conditions here very different from those which prevail in much of North America. Market pressures that favor the opening of retail markets elsewhere are not as significant in Québec. Electricity prices in Québec, as in other parts of the continent where hydroelectricity predominates, are among the lowest in North America.

That is why the opening of the Québec retail market appears less pertinent and why, given the absence of evidence suggesting tangible advantages for Québec customers, Hydro-Québec does not intend to promote the opening of the province's retail electricity market.

The *Act respecting the Régie de l'énergie* does state that the government may, when it believes it opportune, ask the *Régie de l'énergie* to explore the opening of the retail market.

North American Market

Average price of electricity by state and province
(1995 overall average, in U.S.¢/kWh)



U.S. electricity market
U.S. \$200 billion

Northeastern U.S. market
U.S. \$55 billion

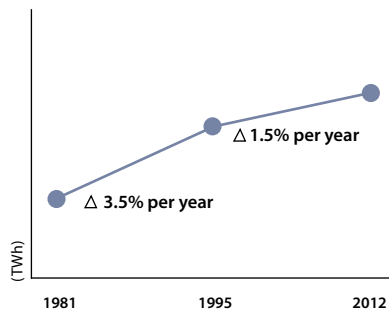
Highest and lowest rate zones

- > 9.0 U.S.¢/kWh: Northeast and California
- < 4.5 U.S.¢/kWh: mostly hydroelectric regions

Energy sources of U.S. utilities:

- 55% coal
- 22% nuclear
- 10% gas
- 10% hydroelectric
- 2% oil

**Growth in Demand
1981-2012**



Demand in Québec

The energy market is driven by the economy. From 1981 to 1995, the demand for electricity, after energy savings, rose on average 3.5% per year, fueled by strong growth in demand from the industrial sector. Over the next 15 years, demand should rise at an average rate of 1.5% per year. This moderate growth rate reflects the steady expansion of a highly diversified economy. By 2002, this growth will result in additional sales of 14.1 TWh per year.

The moderate growth in Québec demand, compared with the 1981-1995 period, is due to:

- a slowdown in demographic growth;
- more moderate growth in new large-power industrial installations;
- a general improved efficiency in electricity consumption.

The table below shows the electricity demand forecasts for Québec through to 2002, based on an average-growth scenario.

Forecast Electricity Demand in Québec by Sector (in TWh)

	1997	1998	1999	2000	2001	2002
Residential and farm	51.5	51.5	52.1	52.7	53.3	53.9
General and institutional	29.8	29.7	29.8	29.8	30.2	30.5
Industrial	62.7	63.4	64.7	67.0	70.3	73.6
Other	5.4	5.5	5.5	5.6	5.7	5.8
<i>Total</i>	<i>149.5</i>	<i>150.0</i>	<i>152.1</i>	<i>155.1</i>	<i>159.6</i>	<i>163.9</i>
Energy conservation	- 2.6	- 2.9	- 3.0	- 3.0	- 3.0	- 3.0
Total sales in Québec	146.9	147.1	149.2	152.2	156.6	161.0

Energy efficiency

Considerable progress has been made in energy efficiency within Québec as a result of changes in electricity consumption habits, significant investments in building insulation, and the gradual replacement of old household appliances, public lighting fixtures, pumping and ventilation systems, and industrial machinery.

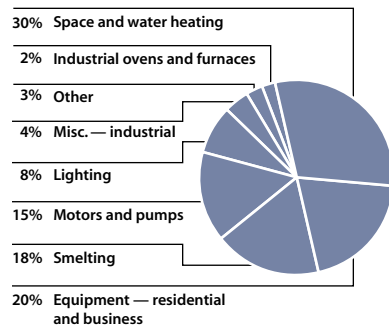
Following widespread campaigns to raise public awareness of the importance and ways of conserving energy, more than half of Hydro-Québec's customers responded by, for example, lowering the temperature in their homes. Québec's energy-efficiency record is all the more remarkable in that Quebecers have access to inexpensive electrical energy. This performance is, indeed, recognized within the industry. The following factors have contributed to the province's reputation:

- changes to the residential and commercial building code since 1971 have made Québec buildings among the best-insulated in the world;
- most electric water heaters meet a high efficiency standard (C-131);
- electric space heating, generated from hydropower, is used in nearly 70% of Québec homes and results in less than 10% energy loss, compared with at least 30% for fossil-fuel heating;
- more than 99% of public lighting in Québec uses high-performance sodium technologies;
- most large-power industries — pulp and paper, metallurgy, motorized processes — utilize state-of-the-art technology.

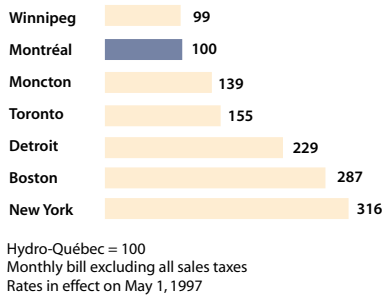
The Québec government's Energy Policy provides for the creation of an energy-efficiency agency, known as the *Agence de l'efficacité énergétique*, which will act as "a neutral, credible agency whose mission will be to see to the promotion of energy efficiency for all types of energy, in all sectors of activity, and for the benefit of all regions of Québec."

This mandate suggests that the agency will serve as an expert and consultant to public authorities, companies, and consumers in general.

Electricity Sales by Use



Residential Customers
Comparative index of electricity prices



Hydro-Québec’s competitive position

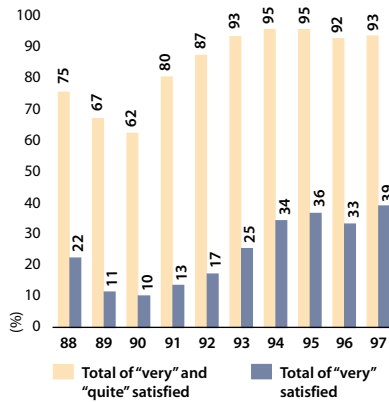
Associated with modernity and new technologies, electricity plays a vital role in Québec’s energy mix. As the sole distributor for more than 97% of the Québec market, Hydro-Québec benefits from this favored market position and the multiple uses of electricity.

Apart from uses exclusive to electricity — e.g., lighting, information- and multi-media technologies, household appliances, and automation — electricity is also widely used in air conditioning and home heating. It shares the commercial, institutional and multi-family-dwelling heating market with natural gas and oil. The only sectors where electricity is absent, with a few exceptions, are ground transportation and industrial heating.

This underscores the competitiveness of rates offered by Hydro-Québec. Its residential rate is among the lowest in North America, which explains the extensive use of electricity in new residential construction.

Hydro-Québec’s service quality also contributes to electricity’s excellent position in Québec. Today, over 90% of Hydro-Québec’s customers say they are satisfied or very satisfied with the company, which attests to the success of efforts made to considerably improve its understanding of customers’ energy needs, expectations and consumption patterns.

Rate of Public Satisfaction with Hydro-Québec (yearly average)



Situation Outside Québec

Hydro-Québec has achieved substantial electricity sales outside Québec for some time now. In 1996, for example, these sales amounted to \$600 million. The evolution of markets outside Québec is therefore important to the company.

The United States

The adoption of the *Energy Policy Act* (EPA) by Congress in 1992 was the catalyst for opening the wholesale market, electricity transmission systems, and the retail market in the United States.

Orders 888 and 889 of the Federal Energy Regulatory Commission (FERC) then followed, sanctioning the opening of the wholesale market and transmission systems. Order 888-A later confirmed certain complementary provisions, including the obligation for reciprocal access to the transmission systems and wholesale markets of foreign entities which want to do business on the U.S. wholesale market.

Thus, since January 1, 1997, the U.S. wholesale market and transmission systems have been open, meaning they are directly accessible under non-discriminatory conditions. This is a major change for Hydro-Québec since it now has access to a diversified market and customer base. Another interesting outcome is the creation of power exchanges that enable producers like Hydro-Québec to participate in short-term markets via direct tenders. More recent developments — in particular, the proliferation of intermediaries and the numerous partnership offers coming in from major industry players — suggest that Hydro-Québec will be able to choose either to operate directly in markets with a license issued by the FERC, or to deal with a large number of intermediaries at the Québec border.

Retail market

In the United States, the decision to open the retail market and the establishment of conditions rests with each state. In most states, the process is well under way. For some, such as California, Massachusetts, Rhode Island, and Pennsylvania, retail markets are due to be opened on January 1, 1998. In these states, the high cost of electricity, the initiative of legislative assemblies and regulatory boards, and the fragmented ownership structure of production, have facilitated the early opening of the retail market.

The opening of the retail market in the U.S. means that consumers will eventually be able to choose their electricity supplier. This will lead to the emergence of retail power marketers, who are not necessarily producers, but who sell electricity from various sources at the lowest possible price. Transmission and distribution systems will act like a public road network, over which suppliers will be able to deliver electricity they produce or purchase to customers who will have chosen them. Suppliers will pay the tariffs for access to these systems.

Stranded costs

Market restructuring in the United States is expected to create substantial stranded costs. Stranded costs refer to what it will cost, within the context of the opening of the retail market and the establishment of a free market for electricity generation, to:

- write-down non-performing facilities (obsolete nuclear or thermal generating stations) owned by utilities, at their probable market value;
- re-open power supply contracts established at above-market prices;
- amortize demand-management programs over a shorter period of time than initially anticipated.

In 1996, Moody's estimated that stranded costs in the United States could reach U.S.\$135 billion.

Actual costs may well be less.

The major question to date has been to determine who will pay the bill. In a study conducted in 1996 by Moody's Investors Service, it was estimated that stranded costs in the United States could reach U.S.\$135 billion.

These overall costs, however, may well be less. In recent transactions, utilities have been able to sell blocks of production assets above book value. This rather unexpected development may mean that buyers are anticipating higher electricity prices on U.S. markets, an advantageous development for Hydro-Québec.

Mergers and acquisitions

The past few years have seen an unprecedented increase in mergers and acquisitions in North America involving electricity, gas, and oil companies. For the most part, these transactions reflect a trend toward the convergence of various types of energy. They are driven by objectives of critical mass, geographic diversification, or synergy in the production and supply of energy products and services.

Recently, these transactions have also included diversification initiatives involving the telecommunications sector and the provision of integrated residential services (security, telecommunications, energy, etc.).

Major Mergers and Acquisitions in 1996

	Revenue (in billions of U.S.\$)
Enron • Portland General Corp.	14.4
Duke Power Co. • PanEnergy	12.3
Tenneco Energy • El Paso Energy Co.	9.9
Houston Industries • NorAm Energy Corp.	8.9
Texas Utilities Co. • Enserch	8.7
Centerior • Ohio Edison	5.0

In 1996 alone, there were about a dozen mega-transactions on the U.S. energy market. The table on the left shows the major mergers and acquisitions and the resulting consolidated revenue, which provides a basis for comparison with Hydro-Québec, which posted \$7.7 billion (U.S.\$5.6 billion) in revenue in 1996.

The inevitable conclusion is that U.S. energy sector leaders are very active, and are taking advantage of the industry's restructuring to accelerate their growth.

Situation in Canada

The electricity industry in Canada has also embarked on a period of major restructuring.

In British Columbia, BC Hydro, like Hydro-Québec, has opened its transmission system and its wholesale market. Its subsidiary, Powerex, is the second Canadian company to be granted a full license from the FERC to do business in the U.S. on a market basis.

In Alberta, efforts are under way to implement a new market structure comprising a power exchange and the designation of an independent administrator for the transmission system.

In Ontario, the provincial government has announced that it will soon release a White Paper on the restructuring of Ontario's electricity industry. This paper will be published at a time when major issues related to the operation of the province's nuclear generating facilities are being addressed. Ontario Hydro recently estimated that the cost of upgrading its nuclear plants, and of purchasing energy during the shutdown of plant operations, could reach \$8 billion.

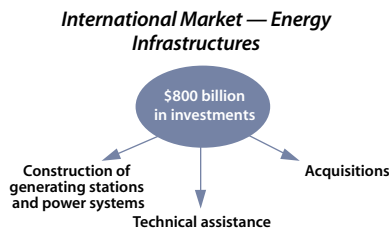
In New Brunswick, the government there is preparing to put in place measures to enable the province to join the movement toward the opening of electricity markets. A first step will be taken in early 1998, when the province's independent producers will be able to use New Brunswick Power's transmission system to export their production (wheel-out), and external producers will be able to use the system to transit energy to customers outside New Brunswick (wheel-through).

International Situation

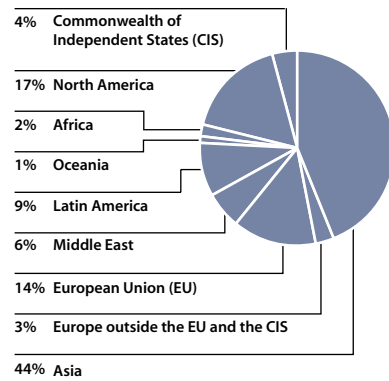
World energy demand is expected to show strong growth over the next 10 years, primarily due to energy requirements in the newly industrialized or developing countries of Asia, South America and, to a lesser degree, Eastern Europe.

In most of these regions, the absence or shortage of energy infrastructures often constitutes one of the biggest obstacles to economic growth. These new requirements are expected to generate investments of about U.S.\$800 billion by 2007, including \$400 billion in Asia. In China alone, energy requirements will correspond to the addition, every three years, of capacity equal to Hydro-Québec's total capacity.

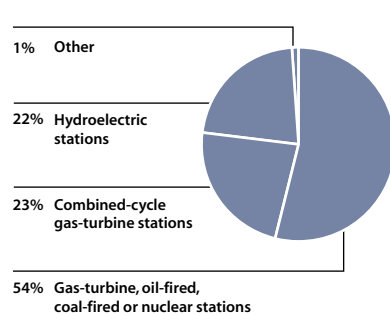
Access to capital and know-how is another major hurdle for many of these countries which are experiencing rapid economic and demographic growth. They are thus inviting companies operating on the international scene to invest in their energy infrastructures in order to accelerate development.



Additions to World Electricity Generating Capacity by Region



Additions to World Electricity Generating Capacity by Technology



By 2003, an estimated \$160 billion in investments will be needed just to meet the world's new hydroelectric requirements, primarily in Asia and South America. Electricity transmission needs can already be foreseen for these regions. What if Hydro-Québec were to replicate, in these regions, projects similar to those it has successfully implemented in Québec, combining hydroelectric development and the development of industries such as pulp and paper or aluminum?

Electricity from non-nuclear, thermal generation is expected to occupy more than 60% of the new-capacity market by 2003. To establish a strong foothold in international markets, Hydro-Québec believes it is important to be involved in the development of thermal generation facilities, particularly natural gas.

Internationally, Hydro-Québec can already rely on the excellent credibility gained through its achievements in Québec, as well as its world-class technical expertise and know-how. However, Hydro-Québec's efforts on the world stage to date have only focused on technical assistance, which represent a very limited portion of the market opportunities.

Chapter 3 Corporate Orientations 1998-2002

Hydro-Québec's orientations for the 1998-2002 period and their related objectives stem from a desire for sustained growth and profitability, and a concern for continuity.

The company's orientations reflect the business opportunities open to Hydro-Québec given its traditional activities in Québec, the restructuring of North American energy markets, and the emergence of Québec as a major energy hub.

These business opportunities flow from the:

- growing demand for electricity in Québec;
- opening of markets peripheral to Québec;
- profitable investment outlook in hydroelectric generation and electricity transmission;
- growth potential arising from the convergence of various forms of energy;
- other business opportunities that are complementary to the company's current activities and services; and from
- growing energy requirements on international markets.

Hydro-Québec has a number of major advantages that position it well to seize these opportunities:

- hydroelectric potential that can be developed at costs as competitive as its existing production costs;
- access to attractive markets peripheral to Québec;
- employees with the necessary expertise and know-how;
- strong financial capability;
- financing costs that have rarely been as attractive as today, given current low interest rates and the shrinking of yield spreads between Hydro-Québec bonds and those of Ontario Hydro and the Government of Canada;
- a high-quality network of industrial alliances; plus
- a worldwide reputation.

Given these competitive advantages, Hydro-Québec, as a public company, is determined to manage on a “business first” basis, convinced this will enable it to become a more effective driving force in Québec’s economic development. Hydro-Québec has therefore adopted five major orientations for the 1998-2002 period:

- 1 Maintain rates and service quality in Québec**
- 2 Put Hydro-Québec back on the path to growth and reasonable profitability, while respecting the environment in cooperation with local communities**
- 3 Develop a world-class international activity base**
- 4 Ensure that all employees contribute to Hydro-Québec’s development and ensure continuity of know-how**
- 5 Turn R&D into an instrument of growth and profitability for the company**

These orientations in turn include various strategies, objectives, and means. They are indivisible, since the objectives tied to one cannot be achieved unless the objectives related to all the others are achieved.

3.1 Build on Achievements

Hydro-Québec is well aware that the confidence Quebecers place in the company is a key factor in its future success. As it enters the 1998-2002 period, Hydro-Québec is determined it will continue to merit this trust through its actions, and through the quality of its services.

This is the primary reason for Hydro-Québec's first orientation:

Orientation 1

MAINTAIN RATES AND SERVICE QUALITY IN QUÉBEC

This orientation reiterates Québec's social pact regarding electricity, based on the benefits flowing from the nationalization of electricity. The components of this pact, which Hydro-Québec reaffirms, are:

- uniform rates by customer category throughout the power system;
- rate stability for all customer categories ensured by hydroelectric generation;
- low rates, particularly in the residential sector;
- public ownership of the company.

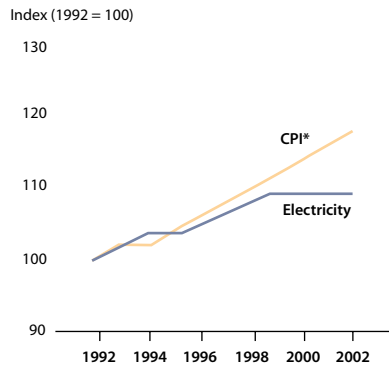
This orientation will be supported by four strategies:

- ▶ *Freeze rates for the period ending April 2002, after an inflation adjustment on May 1, 1998.*
- ▶ *Regulate Hydro-Québec's generation on the basis of price.*
- ▶ *Maintain service quality in accordance with customer expectations.*
- ▶ *Improve efficiency.*

Benefits for Québec Customers

- Uniform rates
- Low rates
- Stable rates
- Service quality

Changes in Electricity Prices and Inflation 1992-2002



* Consumer price index

► **Freeze rates for the period ending April 2002, after an inflation adjustment on May 1, 1998**

The rate freeze for the period ending in 2002 reflects Hydro-Québec’s intention of improving profitability through the growth of its markets and activities.

This freeze also aims to remove any uncertainty Québec consumers may have about the evolution of rates subsequent to the opening of Québec’s wholesale market and transmission system.

It should also facilitate the rapid implementation of the new regulatory framework for Hydro-Québec’s activities laid down in the *Act respecting the Régie de l’énergie*, particularly as regards power supply rates.

Finally, the freeze is bound to stimulate investment in Québec and thus support the company’s sales forecasts for the next few years.

► **Regulate Hydro-Québec’s generation on the basis of price**

The regulation of Hydro-Québec’s generation is one of the key elements stemming from the *Act respecting the Régie de l’énergie*. It is intricately linked to the issue of supply rates.

The *Régie de l’énergie* must, based on a proposal from Hydro-Québec, advise the Québec government on the terms of establishing and implementing power supply rates. Under the Act, “supply” corresponds to the “energy” portion of the customer’s bill, to which must be added the transmission, distribution and customer service rates.

Hydro-Québec is fully cognizant of the benefits Québec customers have achieved from rate uniformity and stability. It is also aware of its dominance of the domestic market, since it produces or purchases more than 97% of all the electricity consumed in Québec. The company therefore recommends the following principles for regulating electricity generation in Québec and for establishing a power supply rate:

- establish a generation price, and thus a supply rate, based on the large-power rate (Rate L), which does not include any distribution component, less the transmission rate for this customer category;
- establish a generation price, and thus a supply rate, based on load factors, which is uniform throughout the system for all rate categories.

Rate L — Large Power

(as of May 1, 1998)

3.80¢/kWh

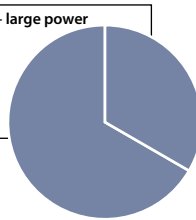
1.27¢/kWh

Transmission at Rate L — large power

2.53¢/kWh

Supply rate at Rate L — large power

Equivalent to 2.87¢/kWh based on average utilization factor for all sales subject to Rates Bylaw



These principles should help establish the price-based regulation of electricity generation. It should be noted that several countries, including the United Kingdom, have already adopted this type of “price-cap” approach.

Hydro-Québec believes that this proposal, while safeguarding the benefits of the electricity social pact, also offers the following additional advantages:

Average Price of kWh in Québec

(as of May 1, 1998)

• Supply rate	2.87 ¢
• Transmission rate	1.53 ¢
• Distribution and customer service rate	1.20 ¢

Average total rate: 5.60 ¢

(Sales subject to the Rates Bylaw)

- the price-based regulation of generation is a flexible and modern approach. It is particularly well-suited to Québec, where electricity prices are low and are expected to remain stable;
- such regulation will allow the *Régie de l'énergie* to exercise full control over electricity supply rates in Québec, and provide Hydro-Québec with the flexibility it needs to compete outside Québec, where generation will be largely unregulated;
- the approach is compatible with the price-based regulation of the natural monopolies of electricity transmission and distribution, as provided for in the *Act respecting the Régie de l'énergie*, and as is already the case for natural gas in Québec;
- the approach is compatible with Hydro-Québec's obligation as an electricity distributor to obtain approval for its resource plan, that is, a comprehensive plan for supplying distribution customers, similar to that expected for gas distributors.

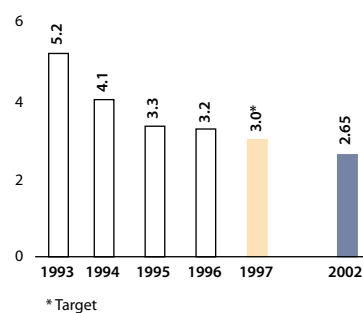
This proposal from Hydro-Québec, and the opinion of the *Régie de l'énergie*, will enable the government to decide how to regulate electricity generation in Québec. Hydro-Québec's proposal contributes to the regulation of generation and the introduction of supply rates, without modifying existing overall rates for all customer categories.

► Maintain service quality in accordance with customer expectations

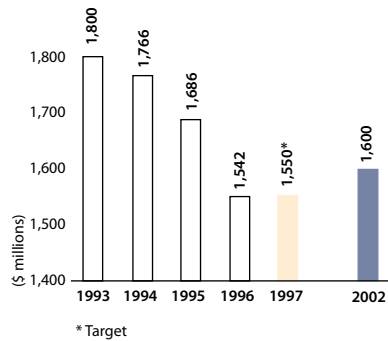
Quality and reliability of service are among Hydro-Québec's most important priorities. It will therefore concentrate efforts on, and closely monitor, these two key priorities. The company will also continue to adjust to meet evolving customer requirements.

By 2002, Hydro-Québec expects to lower the average number of hours of service interruption to 2.65 hours per customer per year. This index fell from 5.2 to 3.2 hours between 1993 and 1996.

Average Number of Hours of Service Interruption Per Customer Per Year (non-adjusted index)



Operating Expenses



► **Improve efficiency**

Hydro-Québec understands the high expectations the public has with regards to the company. Consequently, it will continue to use sound management practices to continuously improve the efficiency of its activities. This strategy includes the following objectives for the 1998-2002 period:

- stabilize operating expenses at \$1.6 billion;
- limit non-income-generating investments to 1.2% of capital expenditures for distribution, and to 2% for transmission;
- increase the utilization and load factors of the transmission and distribution systems;
- gradually shift available internal resources toward new growth activities;
- charge for work done for third parties and non-standard connections at full cost.

The company will also ensure that the public is kept fully informed of its activities and, in particular, of its performance. In this way, members of the public will be able to closely follow Hydro-Québec's progress.

3.2 Focus on Growth and Profitability

Hydro-Québec plans to seize business opportunities in markets within and outside Québec, thus fulfilling the role set forth in Québec's Energy Policy: to act as a key player in making Québec a major energy hub.

That is precisely the focus of Hydro-Québec's second orientation for the 1998-2002 period:

Orientation 2

PUT HYDRO-QUÉBEC BACK ON THE PATH TO GROWTH AND REASONABLE PROFITABILITY, WHILE RESPECTING THE ENVIRONMENT, IN COOPERATION WITH LOCAL COMMUNITIES

This orientation is largely based on the opportunity to complete the development of Québec's hydroelectric potential, in line with the developments of the past 30 years. Over that period, Hydro-Québec has given Québec one of the most competitive hydroelectric generating capacities in North America, placing it among the leading electricity producers on the continent.

There are four strategies underpinning this orientation:

- ▶ *Significantly increase electricity sales on all markets within and outside Québec.*
- ▶ *Communicate the environmental benefits of Hydro-Québec's generating facilities and its system as a whole.*
- ▶ *Develop and market new products and services related to generation, marketing, transmission, distribution and customer service, or associated with under-utilized assets.*
- ▶ *Adapt the company's financial policies and accounting practices to the context of growth and the opening of wholesale markets.*

Growth and reasonable profitability

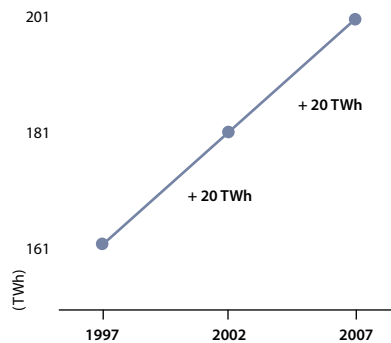
Increase in electricity sales within and outside Québec

New products and services

► **Significantly increase electricity sales on all markets within and outside Québec**

Hydro-Québec has set an objective of new sales of 40 TWh on all markets within the next 10 years. This represents a 25% increase in annual sales by 2007 over the 161 TWh sales forecast for 1997.

Total Sales — 1997-2007 Objective



As the following table (*Energy Balance 1997-2002*) shows, the company is aiming for:

- sales of 181 TWh in 2002 — 20 TWh over 1997 and 50% of the 10-year target. These sales are made up of: 14 TWh in Québec, and 6 TWh outside Québec.

These additional sales will be achieved through:

- 12 TWh from the current energy capacities at average runoff;
- 8 TWh from projects related to developing some of Québec's hydroelectric potential, to be carried out and commissioned by 2002.

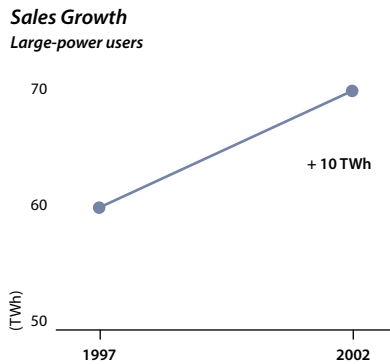
Energy Balance 1997-2002

Energy requirements (TWh)	1997	2002	Δ 1997-2002
Sales in Québec	147	161	+ 14
Sales in external markets • Current contracts	10	2] 20
Sales in external markets • New markets	4	18	
Total sales	161	181	+ 20
Deliveries as per agreements	6	6	
Electricity losses (transmission and distribution)	13	15	+ 2
Total requirements	180	202	+ 22
Supplies (TWh)			
Current generating facilities	154	154	
Current purchases	36	36	
Other*	2	4	+ 2
Completion • Partial diversions and other	0	6] + 8
Sainte-Marguerite-3	0	2	
Total supplies	192	202	+ 10
Surplus at average runoff	-12	0	+ 12
Total net supplies	180	202	+ 22

* Note: Additional supplies of 2 TWh appear under "Other," which includes purchases on short-term markets and the marketing of storage capacities. This contribution makes up for the increase in system losses, which are a normal consequence of power-system operations.

▷ **Markets**

To expand its markets and increase its sales, Hydro-Québec plans to:



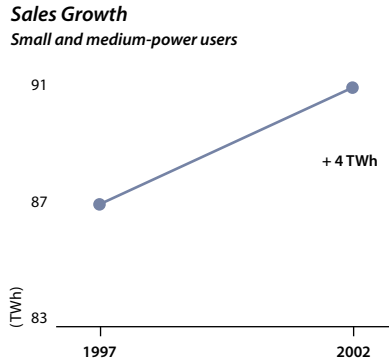
1. *Develop large consumption markets in Québec (Rate L)*

Hydro-Québec intends to achieve annual sales of 70.5 TWh in 2002 on Québec large consumption markets, 10 TWh more than in 1997, an increase of 16.5%.

These new sales will stem in part from the general increase in industrial output due to Québec's economic growth over the 1998-2002 period, and also from the penetration of high-performance electrotechnologies in industrial enterprises.

The company will continue to support industrial development projects by offering, as it does all its customers, reliable, quality supply at competitive rates applicable throughout Québec. The 500-MW objective related to industrial projects proposed at the summit on Québec's social and economic future in October 1996, is being maintained.

The opening of the North American market will not lead to uniform industrial rates across the continent. Hydro-Québec will continue to sell electricity to its industrial customers in Québec at regulated rates which, as indicated earlier, will be stable and advantageous, while selling electricity at market price elsewhere in North America. These market prices will be higher than the Québec rate, given the competitive advantage of Québec's hydroelectric generation compared to other means of production, and the transmission costs between markets. Consequently, the competitive edge will be maintained, making it unnecessary for special rates to be granted in order to attract new industries to Québec.



2. *Ensure the market shares for small and medium-power users in Québec are maintained (Rates D, G and M)*

Hydro-Québec plans to achieve annual sales of 90.5 TWh on the Québec markets for small and medium-power users by 2002, that is, 4.1 TWh more than in 1997, an increase of 4.7%.

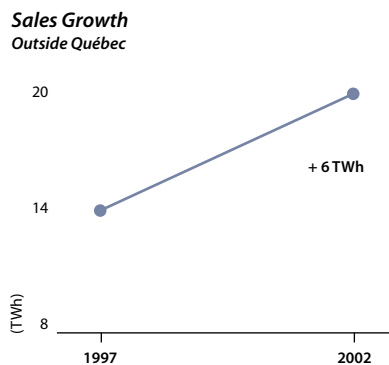
This objective is designed to maintain the company's market shares in the residential, farm, commercial and institutional sectors. To do so, Hydro-Québec will implement marketing programs aimed at retaining profitable market segments and at increasing the penetration of high-performance electric technologies.

3. *Promote energy efficiency and make Québec customers aware of the benefits of properly managed energy consumption*

Recent experience in energy efficiency in Québec has shown the excellent performance and popularity of well-targeted and cost-effective programs for customers, and the difficulty of implementing programs that result in higher costs for customers.

Over the 1998-2002 period, Hydro-Québec plans to make its energy-efficiency programs cost-effective without compromising the gains in energy conservation. The 3-TWh gains realized since 1990 will be maintained.

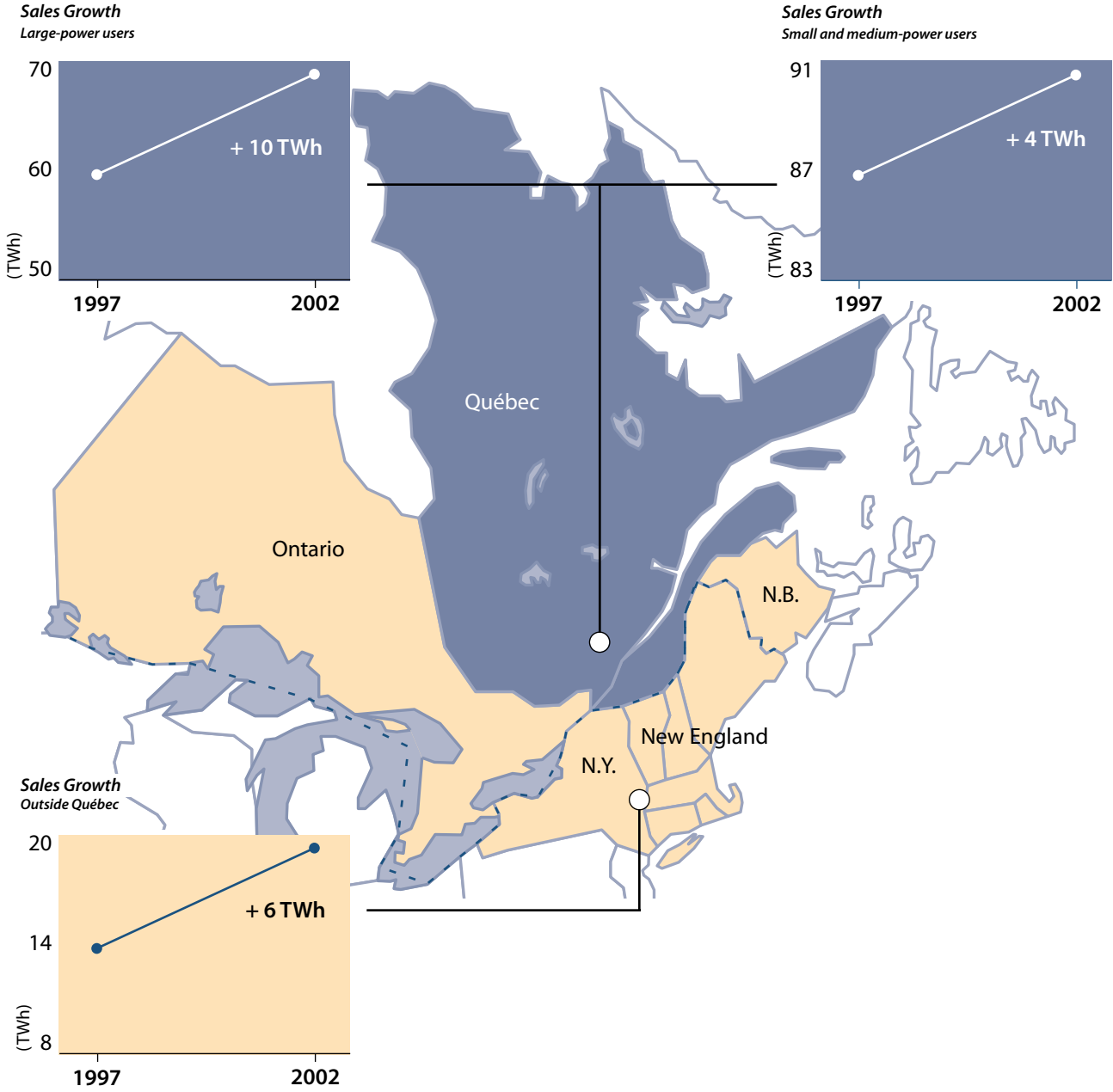
Hydro-Québec will thus continue implementing cost-effective programs based on the planned supply rate of 2.87¢ per kWh, such as *Écono-Confort*, *Nouveau Confort* and *Isolation*, along with initiatives such as the community project to reduce the customer's electricity bill, aimed at low-income households and managed in partnership with community organizations.



4. *Develop markets outside Québec to complement domestic markets*

Hydro-Québec intends to achieve annual sales of 20 TWh on all markets outside Québec by 2002, an increase of 6 TWh or 40% over 1997. The company expects that these sales will be achieved at a 25% higher average price, by 2002, than that of 1997.

Hydro-Québec's Sales Growth 1997-2002



This net increase of 6 TWh does not, however, entirely reflect the efforts that will be made to develop markets outside Québec over the 1998-2002 period. The company will have to replace 8 TWh in annual sales outside Québec covered by long-term contracts that will terminate by the year 2002. Efforts to develop markets outside Québec over the 1998-2002 period will therefore be in the order of 14 TWh.

Hydro-Québec intends to adopt two approaches in order to reach its objectives. It will make direct sales to customers in the wholesale market and to industrial customers outside Québec to maximize revenue from these deliveries. And it will penetrate segments of the retail markets outside Québec, as they become accessible, through alliances with local resellers. In both these cases, the company's goal will be to gain a permanent foothold in markets outside Québec.

Hydro-Québec will also take other measures, including developing its marketing expertise related to the opening of wholesale and retail markets outside Québec, lobbying for non-discriminatory access to all markets, and making more frequent representations to regulatory agencies outside Québec whenever the company's interests are at stake.

Three conditions for proceeding with projects to complete the development of Québec's hydroelectric potential

The project must be:

- Profitable
- Environmentally acceptable
- Well received by local communities

▷ ***Generation and supplies***

To achieve its growth and profitability objectives with respect to new sales, Hydro-Québec will require additional generation and supplies at competitive terms. That is why Hydro-Québec plans to pursue the completion of the development of Québec's hydroelectric potential. Projects will be undertaken on three conditions:

- they must be profitable in light of market conditions and the prevailing supply rate, that is, the "energy" component of sales in Québec, estimated at 2.87¢/kWh, on average;
- they must be environmentally acceptable, in accordance with the principle of sustainable development; and
- they must be well received by local communities.

“Partial diversion” refers to the diversion of a portion of a river’s flow in order to increase the runoff of a basin that has already been developed for hydroelectric purposes, while maintaining an environmentally acceptable controlled flow in the original river bed.

Limited partnerships for projects aimed at completing the development of Québec’s hydroelectric potential

- | | |
|------------------|---------------------------------------|
| Limited partners | • Hydro-Québec
• Local communities |
| General partner | • Hydro-Québec |

As part of its long-term development outlook, the company plans to build a portfolio of competitive projects and supply options. By 2002, it expects to have a new generating capacity of 8 TWh in operation, including:

- 2 TWh from Sainte-Marguerite-3 power station, and
- 6 TWh from a portfolio of partial diversions of rivers and other projects.

Overall, Hydro-Québec’s goal by 2003-2004 is to complete 70% of the competitively advantageous projects that can be achieved in the short term.

To facilitate completion of its new projects, the company plans to:

1. Make the projects more acceptable to the host communities

Acceptance by local communities is one of the essential conditions for completing the development of the hydroelectric potential envisaged by the company. Hydro-Québec wants to propose a new form of partnership with local communities, as an alternative to the Integrated Enhancement Program that has been used to date.

Using limited partnerships, Hydro-Québec will propose the direct participation in the investment and realization of projects by local communities. This approach is meant to promote dialogue and the convergence of the economic interests of the host communities and Hydro-Québec over the long term.

Limited partnerships would, within a durable but flexible framework, enable the communities to invest directly in their local projects as partners along with Hydro-Québec. Hydro-Québec would assume the role of general partner, responsible for the financing of projects, as well as their completion and operation. The design work and environmental mitigative measures would be carried out in consultation with the local communities. The profits generated by the limited partnerships would be distributed among all the partners in proportion to their respective share of the capital of the limited partnership.

Finally, Hydro-Québec will continue to consult host communities with respect to future projects. A new formula, the regional consultation and discussion forum, was recently incorporated into the process for the Betsiamites project. At the study stage, this formula will enable host communities to closely monitor projects along with Hydro-Québec. In addition, the company will communicate information of public interest to Quebecers at large.

2. Reduce construction lead times and costs

While respecting quality standards for projects, and all applicable environmental requirements, Hydro-Québec intends to favor approaches that reduce construction lead times. Besides lowering investment costs related to capitalized interest, the company would be able to commission its facilities faster and thus begin generating revenue sooner.

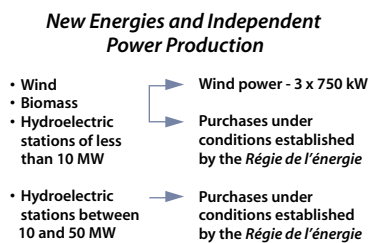
In an effort to maximize the profitability of its projects, Hydro-Québec also plans to adopt optimal construction standards, which will enable it to obtain better prices from suppliers and, in turn, cut the construction costs of its projects.

3. Implement supply programs for new energy sources and independent power production

The Energy Policy provides for the *Régie de l'énergie* to authorize Hydro-Québec to include a wind-energy portion in its future resource plan. To this end, Hydro-Québec recently concluded an agreement for the supply and installation of three 750-kW wind generators in the Gaspé region. This will serve both as a test and as a demonstration wind farm.

In its role as a distributor, Hydro-Québec plans to recommend to the *Régie de l'énergie* that its resource plan provide for the purchase of 20 MW per year of power from new energy sources (wind, biomass, small hydroelectric stations with a capacity of 10 MW or less) for a period of 10 years. These purchases would be made under conditions set by the *Régie de l'énergie*.

To meet its energy requirements, Hydro-Québec is also prepared to purchase power from privately-owned hydroelectric stations with a capacity of 10 to 50 MW, under conditions set by the *Regie de l'énergie*.



4. *Implement a thermal-energy supply program*

To take advantage of the convergence of electricity and natural gas, Hydro-Québec is prepared to set up a supply program for up to 10 TWh of thermally generated power (natural gas). This would serve, for example, on a transitional basis to accelerate the penetration of markets outside Québec.

This strategy lends support to Gaz Métropolitain's initiatives regarding gas pipeline projects (PNGTS to Boston, TMGT to Nova Scotia). These initiatives would contribute directly to the growth of Gaz Métropolitain and indirectly to that of Hydro-Québec, which holds a sizable equity share in Gaz Métropolitain through Noverco.

▷ *Transmission capacity*

To meet the needs of its customers, TransÉnergie, the Hydro-Québec division that operates its transmission system, will need to expand the system and increase transit capacity. The division will develop its facilities so as to establish a link between generating areas and markets accessible to its customers.

To do so, TransÉnergie intends to:

1. *Broaden access by its customers to transmission systems peripheral to Québec*

TransÉnergie's existing system has a capacity of 35,000 MW, including interconnections of some 5,500 MW. TransÉnergie will add new interconnections to its existing system, based on market growth. Additions in excess of 1,000 MW may eventually be required.

TransÉnergie will lobby the authorities that manage the reliability of continental systems, the Northeast Power Coordinating Council (NPCC) and the North American Electric Reliability Council (NERC), to have certain limits lifted regarding the configuration of the Québec system. This could increase the capacity of existing interconnections by 250 MW to 400 MW.

Similarly, TransÉnergie will actively participate in developing and implementing new NERC reliability criteria over the coming years.

TransÉnergie Interconnections

Existing interconnections	5,515 MW
Additional capacity on existing interconnections	250 MW to 400 MW
New interconnections	According to market needs

**Principles for
Transmission Rate**

- Uniform rate
- Average-cost rate
- Includes transmission outside Québec

2. *Offer integrated electricity transmission services that link generating areas to markets*

TransÉnergie intends to be active on markets outside Québec and to propose a uniform transmission rate for all the markets it serves. This formula is based on the following rate principles:

- rolled-in or average cost pricing, for all capacity additions;
- postage-stamp or uniform rate formula, over TransÉnergie's entire system;
- inclusion, in TransÉnergie's basic service, of cost components related to transmission outside Québec for market and generating areas integrated with TransÉnergie's extended system (known as "transmission by others").

The rate design proposed for the transmission of electricity is very similar to that applied in the transportation of natural gas and oil. It is designed to establish a level playing field for the transportation of the various types of energy.

Along with the measures taken by its TransÉnergie division, Hydro-Québec intends to:

3. *Negotiate contracts to reserve strategic transmission channels to optimize energy generation and marketing*

This measure is part of the Hydro-Québec's plan to make Québec a major North American energy hub. Capacities contracted will most often extend to the energy transaction delivery points for markets inside and outside Québec.

Hydro-Québec may also have to contract gas transportation capacities so it can offer multi-energy products and, possibly, support natural-gas thermal generation.

► **Communicate the environmental benefits of Hydro-Québec's generating facilities and its system as a whole**

Hydro-Québec's growth and profitability hinges on a better understanding, both within and outside Québec, of its largely positive environmental record. Hydro-Québec will therefore take steps to better communicate the advantages of hydroelectricity, generally recognized as a "green" and non-polluting source of energy. In this regard, Hydro-Québec intends to use its expertise in mitigating and offsetting the environmental impact of hydroelectric projects to help gain acceptance for its new hydroelectric projects.

Hydro-Québec:

- Sustainable development
- "Green" energy
- ISO 14001

Hydroelectric energy contributes substantially to sustainable development for the entire continent, especially as regards achieving targets for reducing CO2 emissions. Hydro-Québec intends to step up its lobbying efforts with national and international organizations to promote hydroelectricity, particularly in North America, and will seek support from Québec, Canadian and international partners in this endeavor.

Finally, by 2002, the company expects to implement the ISO 14001 standard, which will put managing the environmental impact of its generation, transmission, and distribution activities within the framework of a continuous improvement process. In terms of generation, the system will be implemented gradually between now and the year 2000. The company also intends to continue participating in the Canadian Electricity Association's Environmental Commitment and Responsibility Program.

► **Develop and market new products and services related to generation, marketing, transmission, distribution and customer service, or associated with under-utilized assets**

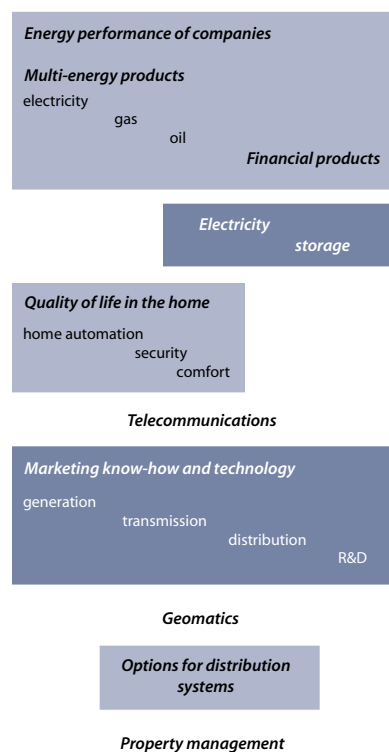
Hydro-Québec has set a target of \$600 million in additional cumulative net income over the 1998-2002 period, including nearly \$200 million by 2002, related to the development and marketing of new products and services.

These products and services will affect all the company's business units, as well as new activity niches in telecommunications and geomatics.

As for products and services related to its core activities, Hydro-Québec will target the following markets:

- large-power customers: multi-energy products (gas, oil, electricity);
- wholesale customers outside Québec: contractual products used to optimize the market value of its generating and storage products and services;
- industry customers: services drawing on its know-how and competitive technology in the areas of generation, transmission and distribution;
- municipalities: optional installations for distribution systems;
- business customers: products and services focused on energy efficiency;
- residential customers: products and services related to home services.

By 2002: New products and services contributing nearly \$200 million to net income



To market its technological assets and products, Hydro-Québec plans to:

- favor partnerships with the private sector from the outset of any technological development;
- shift to its business units the management and development of subsidiaries and holdings related to their core activities;
- increase the profitability of its venture capital investment funds by forging ties with well-established partners in the field;
- reduce its stake in subsidiaries and any other non-strategic holdings to about 30%, in order to maximize its return on investment.

Hydro-Québec also intends to work with partners to find new ways of developing other assets, reducing its operating costs and generating profits from new activities.

Hydro-Québec will follow through on efforts to develop and market its assets and activities in the areas of telecommunications and geomatics, in association with private sector partners.

The company may also make similar efforts in terms of its property, automotive and air transportation assets.

► **Adapt the company's financial policies and accounting practices to the context of growth and the opening of wholesale markets**

As part of its financial planning for the 1998-2002 period, Hydro-Québec will recommend that its shareholder approve a dividend policy based on a payout ratio of 50% of its annual net income. This policy will serve to gradually bolster the company's capitalization ratio by increasing retained earnings.

Further, over the same period, Hydro-Québec also intends to gradually implement certain accounting practices, particularly as regards asset depreciation. It will use the straight-line method of depreciation based on the estimated service life of its facilities, which is standard industry practice.

3.3 Broaden the Potential for Growth

Hydro-Québec intends to seize business opportunities offered by international markets, which is a key factor in ensuring the continuity of its growth, know-how and expertise, as well as that of the Québec electricity industry as a whole.

Development prospects related to Hydro-Québec's core activities within, and in markets peripheral to Québec are not sufficient to ensure the continued growth of the company and the industry beyond the next 10 years. This is why it is so critical for Hydro-Québec to broaden its growth potential via international markets.

This lies at the root of Hydro-Québec's third orientation:

Orientation 3

*DEVELOP A WORLD-CLASS INTERNATIONAL
ACTIVITY BASE*

This orientation translates both the notion of start-up and the global outlook the company plans to adopt.

Two strategies will support this orientation:

- ▶ *Invest in foreign markets as an industrial partner.*
- ▶ *Mobilize the company as a whole to develop international markets.*

International Investments

- Five-year equity investment *Up to \$1.2 billion*
- Long-term return *1.5 times the cost of new debt*

► **Invest in foreign markets as an industrial partner**

Over the 1998-2002 period, Hydro-Québec's objective is to make equity investments of up to \$1.2 billion in international markets. These investments will be made through Hydro-Québec International (HQI), a wholly owned subsidiary of Hydro-Québec.

Over the long term, Hydro-Québec is aiming for a return on equity from its international project portfolio of at least 1.5 times the cost of new long-term debt. Based on current interest rates, this objective is equivalent to a return on equity of 12%. The company does not expect HQI to contribute to its consolidated net income during the early market penetration phase, estimated at five years.

It should be noted that HQI intends to play the role of industrial partner on the international scene, which means it will participate directly and actively in the realization and operation of projects, rather than simply financing them.

The following approach will be adopted:

- HQI will establish, in the short term, technical and business partnerships worldwide;
- HQI will seek an equity stake of 40% on average in projects, so it can be an industrial partner in the majority of its projects;
- HQI will ensure separate stand-alone financing for each project, with no possibility of financial recourse to its overall balance sheet;
- HQI will use technical-assistance and management contracts, as well as the marketing of technologies developed by Hydro-Québec, to penetrate and consolidate its presence in promising markets;
- HQI will acquire, on international markets and for the short or long term, infrastructures or companies with an attractive growth potential in electricity generation, energy transmission and distribution (electricity and gas).

Partnerships will be of prime importance on international markets, and HQI plans to work closely with all its local and international partners. The recent creation of MEG International, a subsidiary owned equally with Gaz de France, which will operate in the natural gas transmission and distribution, as well as the thermal generation sectors, is a concrete example of such partnerships.

**Major International
Market Niches**

- Hydroelectric generation
- Energy transmission and distribution
- Natural-gas thermal generation

► **Mobilize the company as a whole to develop international markets**

Hydro-Québec's success on international markets will depend on the contribution of all its expertise and know-how and the commitment of all employees.

Hydro-Québec therefore plans to:

- use the expertise of personnel assigned to construction projects and the *Société d'énergie de la Baie James* (SEBJ) for international mandates, whenever possible;
- set up a simple management and incentive-based structure for its business units, to support their participation in international projects.

Hydro-Québec will also confirm HQI's role as the company's single window for international affairs.

The company plans to seek partners in Québec's energy sector to share the financial risks and profits of these international activities.

3.4 Rally Employees

Rallying employees to achieve the company's growth and profitability objectives for the 1998-2002 period is essential to the success of the Strategic Plan. Hydro-Québec is fully aware of the central role played by its employees, their expertise and know-how, in achieving past, present and future successes.

Hydro-Québec's fourth orientation is thus to:

Orientation 4

ENSURE THAT ALL EMPLOYEES CONTRIBUTE TO HYDRO-QUÉBEC'S DEVELOPMENT AND ENSURE CONTINUITY OF KNOW-HOW

This orientation highlights the contribution that will be required from one and all to achieve the growth and profitability objectives. It also reflects the company's desire to safeguard, and ensure the transmission of the know-how accumulated over the years to new generations of employees.

Four strategies have been developed to implement this orientation:

- ▶ *Develop a climate of trust within the company.*
- ▶ *Forge ahead with quality-based management.*
- ▶ *Develop a business culture focused on growth and profitability.*
- ▶ *Develop human resources in line with the new industry context.*

Vision

Hydro-Québec wants to become a world leader in energy by developing its expertise for the benefit of its customers, employees and shareholder, and by working with partners in business ventures.

Values

- Customer satisfaction
- "Business first" approach
- Respect for employees
- Quality improvement
- Respect for the environment, in cooperation with local communities
- Safeguarding the future

► Develop a climate of trust within the company

To put an end to the uncertainty that always results from periods of corporate restructuring, Hydro-Québec will finalize, as soon as possible, the streamlining and restructuring process initiated in 1996. It expects to report on the restructuring to the National Assembly Committee on Labor and the Economy in the winter of 1998.

In 1996, Hydro-Québec met its shareholder's requirement to post net income of \$520 million. This result, achieved mainly by a reduction of \$240 million in operating expenses, represented a direct contribution from the company to help reduce Québec's budget deficit for this period. It should be noted that all employees contributed to the turnaround in public finances.

Unions play a major role at Hydro-Québec, and the company strives to maintain relations based on mutual respect, transparency, exchange of information, and the search for mutually acceptable solutions.

Hydro-Québec will guarantee its employees working conditions that reflect not only their skills, their needs and the needs of the company, but also market conditions.

► Forge ahead with quality-based management

Hydro-Québec implemented a new quality-based management system in 1990. The objective was to improve overall performance and, in particular, to fully satisfy customers at the lowest cost. This quality-based management model has proven its worth. By buying into, and contributing to the system, employees became the prime architects of the success of Hydro-Québec's commitment to its customers.

Hydro-Québec intends to forge ahead with its continuous improvement efforts. It will support managers in acquiring and mastering management skills and tools inspired by the best practices in the world, notably in problem solving and results assessment.

► **Develop a business culture focused on growth and profitability**

Hydro-Québec intends to communicate a clear vision based on values shared by all employees. It has set high growth and profitability objectives, which, combined with clearly expressed leadership, will help develop a management style and business practices that are adapted to the new context of the markets.

The company will encourage employees to share these orientations through effective internal communications and training, and will also ensure those orientations and values are translated into the activities of its business units.

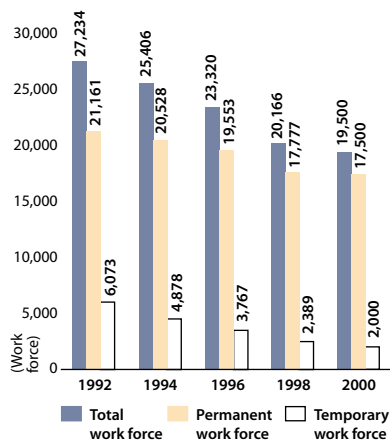
► **Develop human resources in line with the new industry context**

Developing the expertise and know-how of its employees is vital for the success of Hydro-Québec's *Strategic Plan 1998-2002*. The company therefore intends to set up a skills management process that will ensure the effectiveness of its human resources, and give employees better opportunities for personal and career development.

Hydro-Québec also intends to review its human resource management systems and plans, particularly as regards staffing, compensation, and training, in order to foster accountability and the maximum contribution in terms of innovation and creativity. It will also ensure, at all times, the durability and equity of its human resource systems and plans.

Hydro-Québec also plans to hire young people to fill needs created by natural attrition and growth. First, between now and 2002, the company plans to stabilize its total work force at around 19,500, including 2,000 temporary employees mainly associated with seasonal activities. A few years from now, natural attrition should lead to the hiring of about 100 people per year. This attrition should start to increase around 2003-2004, and then settle at a normal level. The hiring of several hundred people per year will then be necessary. This scenario does not include any needs that may arise from other future growth.

**Permanent and Temporary Work Force
1992-2000**



3.5 Maintain Hydro-Québec's Technological Leadership

The technological quality of Hydro-Québec's facilities, activities, products and services constitutes the cornerstone of its world-renowned leadership. This recognition is at once a source of pride for all Quebecers, and a springboard for the future growth and profitability of Hydro-Québec and the Québec electricity industry as a whole. Maintaining the company's technological leadership in its fields of expertise is critical to its future, particularly the industrial role it hopes to play on the international stage.

After 20 years and some \$2 billion invested in R&D, it is time to take stock. Research and development at Hydro-Québec has undoubtedly met with much success, but also with some failures, especially in the marketing of technological products. It is also clear that there is concern about how research is conducted and managed at Hydro-Québec.

To once again experience the success of the past, Hydro-Québec's R&D sector must review its practices, be more open, establish benchmarks for comparison with top research centers around the world, and, above all, be more attuned to its customers and markets. Only then will Hydro-Québec's R&D be able to serve the company's growth over the next 20 years and beyond.

To complete this diagnosis and start on renewing R&D, Hydro-Québec hopes to soon organize a major conference in Québec on the challenges and outlook for R&D in the energy sector on the year 2000 horizon.

This is the backdrop for Hydro-Québec's fifth orientation:

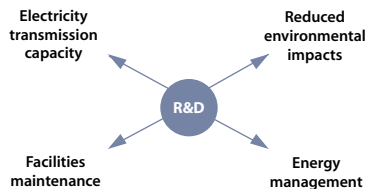
Orientation 5

TURN R&D INTO AN INSTRUMENT OF GROWTH AND PROFITABILITY FOR THE COMPANY

This orientation addresses Hydro-Québec's desire to reap the benefits of its investments of the past 20 years in R&D related to electricity, investments which averaged more than \$100 million a year over the period.

Three strategies are planned to implement this orientation:

- ▶ *Meet the R&D needs of the company's business units on a self-financed basis by 2002.*
- ▶ *Earmark \$20 million per year for the company's future needs in prospective and long-term research.*
- ▶ *Invest, together with partners, in R&D, and in marketing the company's technological assets, with a view to using electricity in ground transportation.*



► **Meet the R&D needs of the company’s business units on a self-financed basis by 2002**

Hydro-Québec will maintain its world leadership in hydroelectric generation and transmission by developing new technologies in fields where it excels. At IREQ, its research institute, Hydro-Québec will focus on R&D mandates arising from the business strategies of its generation, transmission, and distribution units. These mandates will mainly serve to:

- reduce maintenance costs and increase the availability of facilities;
- reduce the environmental impact of facilities;
- develop tools for managing distribution systems and reservoirs;
- develop high-performance electrotechnologies.

These projects could be undertaken in collaboration with universities and other R&D institutions, at home and abroad. Finally, Hydro-Québec will continue to sign contracts with external customers for their use of the company’s technological assets, such as its large laboratories.

► **Earmark \$20 million per year for the company’s future needs in prospective and long-term research**

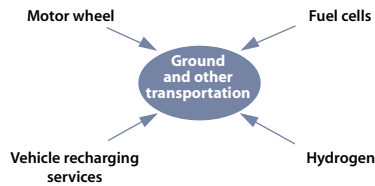
\$20 million per year for prospective and long-term research

This investment will enable the company to play an important role in prospective and long-term research niches.

It will also serve to monitor developments in long-term research options, such as intelligent networks, superconductivity, and telerobotics. The potential economic spin-offs, and the significant business opportunities these options present, will dictate the choice of research areas.

The company’s decision to allocate a sizable yearly amount to long-term R&D clearly testifies to its desire to protect its technological leadership in its core activities.

These investments will also serve to intensify its prospective research efforts to identify potential long-term research options, such as renewable forms of energy (wind and solar), power electronics, fuel cells, dispersed generation, greenhouse gas effects, and the environment in general.



► **Invest, together with partners, in R&D, and in marketing the company’s technological assets, with a view to using electricity in ground transportation**

Hydro-Québec wants to contribute to the use of electricity in ground and other forms of transportation.

The transportation sector accounts for nearly 30% of world energy consumption. Electricity currently plays a negligible role in this sector, but the prospects are very good.

To implement this strategy, Hydro-Québec intends to forge ties with industrial and financial groups to develop, test, and market motor-wheel technology, and to pursue the development of related products. This approach recently gave rise to the announcement of new partnerships.

The company plans to broaden existing partnerships in the sector of lithium-polymer batteries (ACEP), in order to gain a competitive position during the marketing introduction phase.

Hydro-Québec also plans to establish an alliance with automakers to market battery recharging services for electric vehicles.

Finally, Hydro-Québec plans to re-assess its involvement in hydrogen generation.

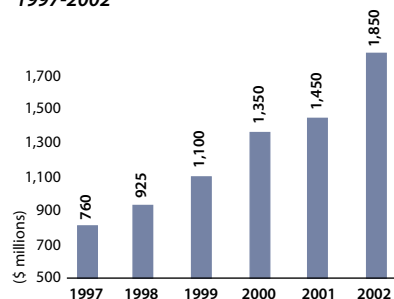
Chapter 4 Financial Outlook

The growth and profitability strategies for the 1998-2002 period will translate into a notable improvement in Hydro-Québec's overall financial situation, particularly in terms of profitability.

The following analysis rests, for 1997, on the April financial parameters, approved in July 1997 by the Board of Directors, and, for subsequent years, on the financial estimates resulting from the *Strategic Plan 1998-2002*.

Consolidated Results — Table 1*

Net Income
1997-2002



Hydro-Québec's consolidated net income will jump from \$760 million in 1997, the latest estimate for the current year, to \$1,850 million in 2002. This increase in net income will be attributable primarily to higher sales within and outside Québec.

Overall electricity sales on all markets will rise by 12% over the period, while sales prices on external markets should climb by 25%. These two factors explain a large part of the increase in revenue, which is expected to rise from nearly \$8 billion in 1997 to almost \$10 billion in 2002.

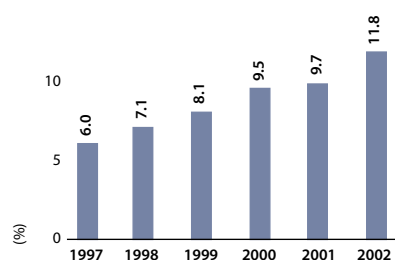
The company will maintain its annual operating expenses at \$1,600 million from 1998 to 2002. The slight increase over 1997 reflects a smaller portion of capitalized expenses for investment projects in the early years, as well as the later increased requirements resulting from the company's new activities.

Other expenses are estimated at nearly \$2,655 million in 1997, and at \$3,592 million in 2002. Depreciation and decommissioning account for 55% of *Other* expenses in 2002. The nearly \$950-million increase over 1997 is attributable almost equally to purchases of electricity and fuel, particularly natural gas for resale as part of multi-energy services, and to depreciation and decommissioning expenses.

Expenses related to interest and exchange losses decline from 2000 on, decreasing to less than \$2,900 million by 2002. This decline is attributable to the reduction in long-term debt, and to a slight increase in capitalized borrowing costs.

*Tables are at the end of this chapter.

**Return on Equity
1997-2002**



The appreciable increase in the company's profitability will result in improved financial ratios across the board for the 1998-2002 period. Return on equity will jump from 6% in 1997 to 11.8% in 2002, a more reasonable level for Hydro-Québec's sector of activity. Interest coverage will rise from 1.20 to 1.51 in 2002.

Based on these consolidated results, the shareholder can expect to receive over \$3.3 billion in dividend payments over the *Strategic Plan 1998-2002* period, according to the dividend policy proposed by the company.

By the end of the period, Hydro-Québec's capitalization ratio should be 31.1%, compared to the ratio of 25.1% expected at year-end 1997.

Changes in Financial Situation — Table 2

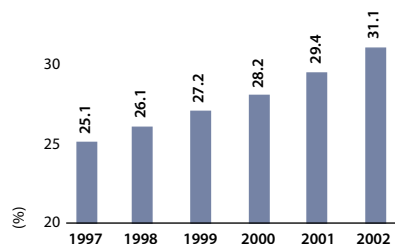
Over the entire 1998-2002 period, operations will generate liquidities of more than \$13.7 billion, after dividends, primarily due to the appreciable increase in net income.

These liquidities will make it possible to finance all Hydro-Québec's planned investments of about \$13.2 billion over the 1998-2002 period, and to allocate \$500 million to reducing long-term debt.

The bottom line for financing activities will reflect a net repayment of debt. The \$11.8 billion in repayment of debt at maturity will exceed the estimated \$11.2 billion in new issues planned.

Self-financing for the period as a whole should stand at 55%, a rate comparable to that for 1996 and 1997.

**Capitalization
1997-2002**

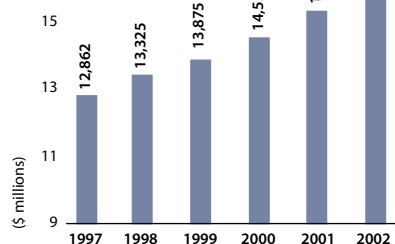


Balance Sheet — Tables 3A and 3B

Over the 1998-2002 period, fixed assets will surpass the \$50-billion mark, with total assets worth \$55.2 billion in 2002. Commissionings will mainly be concentrated in electricity generation and transmission, the areas the most directly related to the program to complete the development of Québec's hydroelectric potential.

On the liabilities side, long-term debt will decrease by more than \$2.4 billion between 1997 and 2002, primarily due to a stronger Canadian dollar, which will lead to a downward adjustment of the U.S.-dollar debt. As Table 4 shows, the Canadian dollar exchange rate in U.S. dollars will rise from 0.731 to 0.794 over the period, based on the economic parameters of the *Strategic Plan 1998-2002*.

**Shareholder's Equity
1997-2002**



Shareholder's equity will increase by more than \$3.2 billion over the period, from \$12.9 billion in 1997 to \$16.1 billion in 2002, bringing the company's capitalization ratio to 31.1% in 2002.

Sensitivity Analysis of Consolidated Net Income for the Year 2000

A sensitivity analysis of the net income forecast for the year 2000 gives an idea of the potential impact on Hydro-Québec of certain economic and other risks.

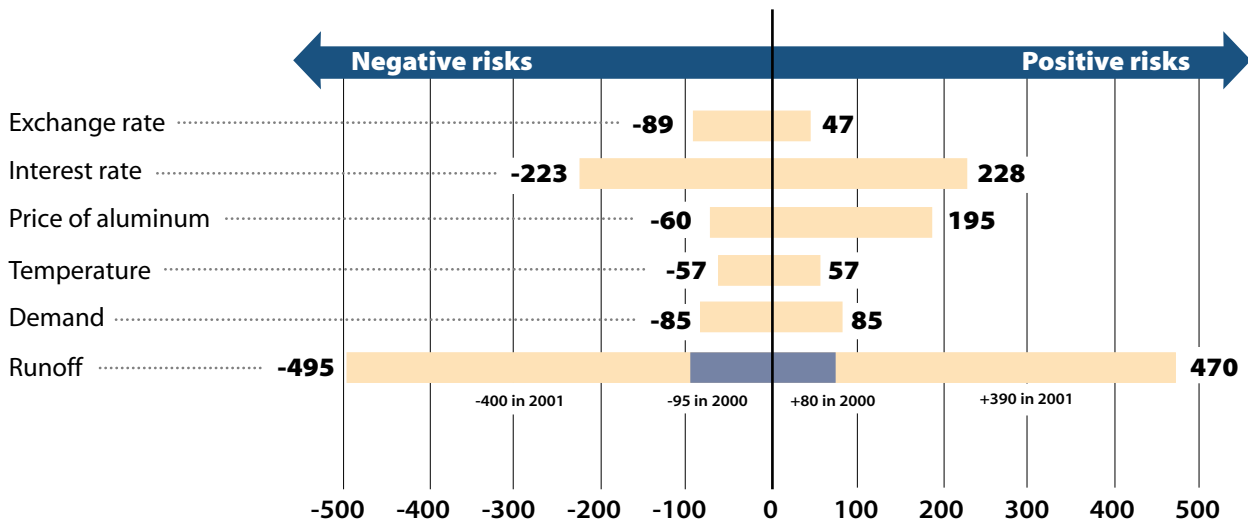
The results shown below cover a 68% probability range. With respect to the interest rate risk, for instance, this analysis indicates there is only a 16% chance that interest rate fluctuations will result in a drop in net income of more than \$223 million, and a 16% chance that such fluctuations will lead, instead, to an increase in net income of over \$228 million.

Among the most important factors likely to affect the company's net income between now and 2002 are changes in interest rates, given the size of the company's debt, and variations in runoff, given the importance of hydropower in Hydro-Québec's total generating capacity.

Sensitivity Analysis on Net Income Forecast for 2000 (\$1,350 million)

Risk associated with basic scenario ± 1 standard deviation* for current year

(in millions of dollars)



* A standard deviation of +1 and -1 covers a 68% probability of the event occurring; consequently, the probability of a standard deviation greater than +1 or less than -1 is 16%.

Table 1

FINANCIAL OUTLOOK 1998-2002

Statement of Consolidated Results (in millions of dollars)

	PRO FORMA					
	1997	1998	1999	2000	2001	2002
Revenues	7,976	8,378	8,674	8,966	9,267	9,821
<i>Less:</i>						
Operating expenses	1,550	1,600	1,600	1,600	1,600	1,600
Other expenses	2,655	2,898	3,003	3,144	3,360	3,592
Interest and exchange loss	3,011	2,990	3,015	2,920	2,908	2,872
<i>Plus:</i>						
Holdings	0	35	44	48	51	93
Consolidated net income	760	925	1,100	1,350	1,450	1,850
Dividend likely to be declared	357	462	550	675	725	925
Return on equity (%)	6.0	7.1	8.1	9.5	9.7	11.8
Interest coverage	1.20	1.24	1.30	1.33	1.38	1.51
Average cost of the debt (%)	8.6	8.7	9.0	9.2	9.2	8.9

Table 2

FINANCIAL OUTLOOK 1998-2002

Changes in Consolidated Financial Situation (in millions of dollars)

	PRO FORMA						Total
	1997	1998	1999	2000	2001	2002	1998-2002
OPERATIONS							
Net income	760	925	1,100	1,350	1,450	1,850	6,675
Depreciation and amortization	1,528	1,577	1,625	1,629	1,718	1,712	8,261
Other	292	(352)	132	(173)	(300)	(509)	(1,202)
	2,580	2,150	2,857	2,806	2,868	3,053	13,734
FINANCING							
Long-term debt							
Issues	1,522	1,317	1,877	2,636	3,574	1,823	11,227
Repayments	(1,857)	(1,227)	(2,359)	(2,442)	(3,342)	(2,401)	(11,771)
	(335)	90	(482)	194	232	(578)	(544)
INVESTMENT							
Fixed assets – Québec	(1,664)	(2,070)	(2,271)	(2,745)	(2,794)	(2,126)	(12,006)
International and other	(581)	(170)	(104)	(255)	(306)	(349)	(1,184)
	(2,245)	(2,240)	(2,375)	(3,000)	(3,100)	(2,475)	(13,190)

Table 3A

FINANCIAL OUTLOOK 1998-2002

Consolidated Balance Sheet (in millions of dollars)

	PRO FORMA					
	1997	1998	1999	2000	2001	2002
ASSETS						
Fixed assets (net)						
Generation	23,112	23,527	24,010	24,649	25,265	25,727
TransÉnergie	14,337	14,472	14,661	15,155	15,604	15,589
Distribution	6,500	6,600	6,634	6,643	6,641	6,636
Other	3,154	2,990	2,896	2,792	2,698	2,464
Total	47,103	47,589	48,201	49,239	50,208	50,416
Current assets	2,137	2,397	2,201	2,245	2,141	2,181
Other long-term assets						
Investments and deferred expenses	3,719	3,134	2,888	2,690	2,349	2,301
Other financial and sundry assets	691	560	500	425	322	342
Total: Assets	53,650	53,680	53,790	54,600	55,020	55,240

Table 3B

FINANCIAL OUTLOOK 1998-2002

Consolidated Balance Sheet (in millions of dollars)

	PRO FORMA					
	1997	1998	1999	2000	2001	2002
LIABILITIES						
Long-term debt	37,937	37,376	36,798	36,721	36,323	35,470
Current liabilities	2,463	2,540	2,624	2,777	2,807	2,891
Other long-term liabilities	388	439	493	552	615	679
Non-controlling shareholders' stake	–	–	–	–	–	65
Total: Liabilities	40,788	40,355	39,915	40,050	39,745	39,105
SHAREHOLDER'S EQUITY						
Share capital	4,374	4,374	4,374	4,374	4,374	4,374
Retained earnings	8,488	8,951	9,501	10,176	10,901	11,761
Total: Equity	12,862	13,325	13,875	14,550	15,275	16,135
TOTAL: Liabilities + Equity	53,650	53,680	53,790	54,600	55,020	55,240
Capitalization (%)	25.1	26.1	27.2	28.2	29.4	31.1

Table 4

FINANCIAL OUTLOOK 1998-2002

Principal Economic Parameters

	1997	1998	1999	2000	2001	2002
Rise in Consumer Price Index (CPI) in Canada (%)	1.8	2.0	2.3	2.5	2.5	2.5
Price of aluminum (in U.S.¢/pound)	79.53	75.99	78.48	85.01	91.89	94.65
Canadian dollar exchange rate in U.S. dollars	0.731	0.742	0.755	0.763	0.781	0.794
Interest rates on 90-day T-bills (%)						
• Canadian market	3.6	4.2	5.0	5.3	5.1	5.1
• U.S. market	5.6	5.9	5.4	5.3	4.6	4.6
Interest rate on Hydro-Québec bonds of 10 years or more (%)						
• Canadian market	7.3	7.8	7.9	7.8	7.7	7.7
• U.S. market	7.6	7.9	7.6	7.3	7.2	7.2

Chapter 5 Economic Impact of the Strategic Plan 1998-2002

Sustaining Employment

Besides the net income it generates, and the dividends it pays to its shareholder, the Québec government, Hydro-Québec also contributes, through its growth, investments, and purchases of electrical equipment and various services, to the economic prosperity of Québec.

Over the 1998-2002 period, Hydro-Québec's activities will help sustain jobs that total the equivalent of 194,100 person-years in all regions of Québec.

The company's operations alone will sustain 94,700 direct and indirect jobs.

Hydro-Québec's investments in generation, transmission, and distribution will exceed \$13 billion over this period and sustain 90,600 direct and indirect jobs.

In addition, through its marketing activities and the activities of its subsidiaries, Hydro-Québec makes a further substantial contribution to the economic life of Québec.

The efforts the company and its customers will make with respect to energy efficiency will help sustain a further 5,000 person-years over the next five years.

The company's purchases from independent electricity producers will contribute 3,800 person-years.

Finally, Hydro-Québec's 11 technological subsidiaries employ some 500 highly specialized individuals, primarily in the Montréal region.

Jobs Sustained by Hydro-Québec's Activities (in person-years)

	1998	1999	2000	2001	2002	1998-2002
Jobs related to operation of facilities*	19,800	19,300	19,000	18,600	18,000	94,700
Jobs related to investments (generation, transmission and distribution)	16,700	17,500	20,300	20,400	15,700	90,600
Jobs related to energy-efficiency programs	1,000	1,000	1,000	1,000	1,000	5,000
Jobs related to purchases from independent power producers	900	800	700	700	700	3,800
Total	38,400	38,600	41,000	40,700	35,400	194,100

* These jobs do not include all Hydro-Québec employees, since some are associated with "Jobs related to investments."

Regional Economic Impact

Hydro-Québec's presence in all regions of Québec has translated into purchases of goods and services worth an average of \$1.9 billion a year over the last four years. In terms of direct and indirect jobs, this represents the equivalent of more than 13,000 person-years.

This, of course, does not include Hydro-Québec's own employees, who are located throughout the province.

Over the period covered by the *Strategic Plan 1998-2002*, the company's purchases across Québec should total about the same as during the 1993-1996 period, given the major investments related to its growth objectives.

The geographic distribution of these economic spin-offs in Québec will, of course, depend on the specific projects that will be approved and carried out. It is therefore impossible to estimate this distribution in advance. Hydro-Québec will nevertheless maintain its purchasing policies, which will lead, as in the past, to purchases being made throughout Québec, at the best possible cost for Hydro-Québec.