

Summary

The global electricity market is going through a period of profound changes designed primarily to create conditions for greater competition in power generation for the benefit of consumers, and to open up power transmission systems for better integration and more efficient development of markets.

In Québec, the wholesale electricity market has been open since May 1, 1997. TransÉnergie, a division of Hydro-Québec, now operates the transmission system in Québec on a non-discriminatory basis for all wholesale customers. The Québec government's Energy Policy (1996) calls on Hydro-Québec to help achieve the policy's objective of putting energy to work for Quebecers in accordance with the principles of sustainable development, while taking full advantage of the changes under way in the North American energy industry.

Elsewhere in Canada, only British Columbia and Alberta have opened up their wholesale markets. Alberta is the one province that has opened its retail market, and only partially. As for Ontario, the provincial government plans to open wholesale and retail markets simultaneously in 2000.

In the United States, market restructuring, combined with the decline in fuel prices seen up until the summer of 1999, has lowered electricity prices on wholesale markets. However, there has also been a drop in generation reserve margins, leading to price spikes during "needle peak" periods. Also, the restructuring of retail markets has proven to be slower than anticipated.

On the international stage, despite the recent slowdown in energy demand in many countries, world energy demand is expected to grow by more than 50% over the next 20 years, leading to major investments in infrastructure.

Corporate Orientations 2000-2004

Hydro-Québec's strategic orientations and objectives for the 2000-2004 period stem from the company's desire to **serve its customers better and contribute to the collective prosperity of Quebecers.**

These orientations reflect the business opportunities open to Hydro-Québec in the context of energy market restructuring. They are related to:

- prospects for profitable investments in the electricity industry in Québec and peripheral markets;
- growth potential arising from the convergence of various forms of energy;
- growing energy requirements on international markets.

Hydro-Québec has many advantages that position it to seize these business opportunities:

- hydroelectric potential that can be developed at costs as competitive as its existing generation costs;
- access to attractive Canadian and U.S. markets peripheral to Québec;
- employees with expertise, know-how and innovative ability;
- strong financial capability and attractive financing costs;
- an excellent network of industrial alliances;
- a worldwide reputation.

Armed with these competitive advantages, Hydro-Québec has established seven strategic orientations for the 2000-2004 period, grouped under three major themes.

Serve Customers Better

Orientation 1: *Maintain rate stability*

Hydro-Québec confirms that its Québec rates will remain frozen until April 2002. After that date, the company will aim to maintain rate stability for all its customers.

Rate stability over the Strategic Plan period should allow Hydro-Québec customers to realize a real gain of about 10% compared with the anticipated rise in the consumer price index (CPI) from 1998 to 2004.

Hydro-Québec plans to increase profitability without raising electricity rates, primarily by developing its markets and reducing financial expenses.

Orientation 2: *Improve service quality*

The improvement of service quality will be pursued on three fronts:

- improve service quality based on customers' priority expectations;
- improve the reliability of power supply for all customers;
- ensure security of supply for Québec customers, at competitive conditions.

Hydro-Québec will adjust its services to the priority expectations of its customers in order to raise the percentage of "very satisfied" customers to 50% — a 20% improvement over its performance at the beginning of 1999. The level of satisfied and very satisfied customers will be maintained at over 90%. Additional objectives are to cut down considerably on the annual average duration of service interruptions for all customers, respond more promptly to customers, and improve communications with municipalities.

Moreover, Hydro-Québec will continue to provide Québec customers with all the electricity they require at all times, at competitive conditions. Growth in electricity demand within Québec will increase sales by 17.4 TWh or 12% compared with 1999. The company aims to generate sales of 171 TWh on all markets by 2004. Its objective of 200 TWh, as stated in the *Strategic Plan 1998-2002*, will be reached by 2010.

Ensure the Company's Profitable Growth in Québec

Orientation 3: *Continue to develop profitable hydroelectric potential*

Hydro-Québec plans to continue developing profitable hydroelectric potential within Québec and on its periphery. This orientation reflects both the economic benefits of profitable hydroelectric projects and the many environmental advantages of hydroelectricity, including its contribution to reducing greenhouse gas emissions, acid rain, and other air pollutants.

Hydro-Québec reaffirms the three conditions for undertaking projects:

- They must be profitable under current market conditions, that is, based on a power-station price of 3¢/kWh.
- They must be environmentally acceptable, in accordance with the principles of sustainable development.
- They must be well received by local communities.

To support this orientation, Hydro-Québec intends to be more proactive in communicating the environmental benefits of hydroelectricity and the company's environmental performance.

Orientation 4: *Stimulate technological innovation within the company*

Hydro-Québec will maintain its technological leadership by refocusing its research and development (R&D) efforts on hydroelectric generation, electricity transmission and distribution, areas in which it will continue to innovate. Close coordination will be required between R&D, technology marketing and venture capital operations.

The company also intends to maximize the benefits of its technological innovations for its core activities, and to reposition its venture capital operations.

Seize Business Opportunities

Orientation 5: *Participate in the development of the North American electricity industry*

Hydro-Québec will rely on its technological expertise and recognized leadership in high-voltage transmission to seek business opportunities in the transmission sector, particularly in niches requiring a high level of technological skill. Hence, the company will participate in the development and application of new technologies designed to reduce congestion in certain electricity transmission corridors.

Orientation 6: *Participate in the development of the North American gas industry*

Hydro-Québec will continue to participate in the development of the North American gas industry through its stake in the holding company Noverco. Enbridge and Gaz Métropolitain, Noverco's operating companies, are active in the large-scale transportation of energy (natural gas, oil and natural gas liquids), as well as gas distribution. Hydro-Québec intends to maintain a very active presence in these important growth industries.

Hydro-Québec will also develop an investment plan that is complementary to its current participation in the gas industry. This investment program could include the upstream sector (excluding exploration, however) and could involve new gas-producing regions in Eastern Canada.

Orientation 7: *Continue international development*

Hydro-Québec's primary goal on the international stage is profitability. Specifically, it aims to obtain an average return on equity of 15% from its international investments, which should also foster medium- and long-term growth and open up major business opportunities for Québec's electricity industry.

In this regard, Hydro-Québec plans to focus its international operations on areas in which it has a high level of expertise, and fine-tune its business partnership approach. The company will join forces, first and foremost, with Québec partners to maximize the spinoffs in Québec.

Financial and Economic Outlook

Hydro-Québec's strategies and company-wide objectives will not only improve customer service, but increase the shareholder's return over the 2000-2004 period.

Hydro-Québec's consolidated net income will jump from \$925 million in 1999, the latest estimate for the current year, to \$1.6 billion in 2004, mainly on the strength of higher sales in Québec. Based on the consolidated results, the shareholder can expect to receive \$3 billion in dividend payments over the *Strategic Plan 2000-2004* period, in accordance with Hydro-Québec's dividend policy.

With the increase in net income, operations will generate funds of close to \$14.3 billion, after dividends, for the entire plan period. These funds will allow the company to finance its entire \$11.9-billion investment program for 2000-2004, and to allocate some \$2.4 billion to its financing operations in order to reduce long-term debt.

Shareholder's equity will increase by \$3 billion, from \$13.7 billion in 1999 to \$16.7 billion in 2004, raising the company's capitalization rate from 26.1% in 1999 to 32.3% in 2004.

In addition to paying dividends to its shareholder, the Québec government, Hydro-Québec also makes a major contribution to Québec's economy through its growth, capital investments and purchases of goods and services, as well as through the taxes it pays.

For the 2000-2004 period, Hydro-Québec's activities will help sustain 183,500 person-years of employment in all regions of Québec.