

Financial Outlook

Financial Outlook for the Strategic Plan 2004–2008

The *Strategic Plan 2004–2008* is on course toward the goal of the past five years: improving the company's financial position.

The following analysis is based on the most recent financial projections, which follow from the economic and energy parameters forecast in this Plan. Economic uncertainty may affect actual results. The parameters used and the financial outlook are therefore presented for illustration purposes only and may be subject to significant variability in the short term, as indicated in the sensitivity analysis presented below.

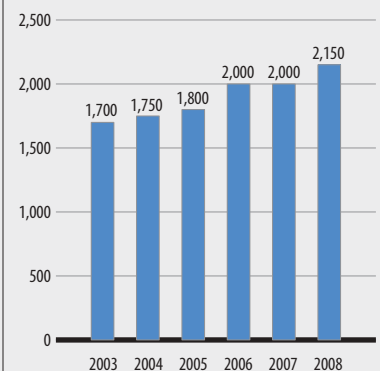
Consolidated Results

In 2003, the company expects net income of \$1,700 million. As its profitability gradually improves over the coming years, net income should reach \$2,150 million by 2008. This growth is due to higher electricity sales, mainly in Québec, tight control of operating expenses and an improvement in the results of international and technology subsidiaries.

Revenue from electricity sales in Québec will increase by \$1,926 million over the period, as a result of steady growth in demand and rate increases that will allow Hydro-Québec Distribution to cover its costs and achieve a reasonable rate of return in a regulated environment. These rate increases, determined on the basis of the principles that govern the Distributor's operations by the Régie de l'énergie, will cover, among other things, the costs of supplying the additional electricity required to meet the increase in demand from Québec customers.

Revenue from electricity sales on markets outside Québec will be lower than in previous years, primarily due to the increase in domestic energy requirements.

Net Income (\$ millions)



Operating expenses will increase by \$450 million over the next five years. More than 90% of this growth will come from the expansion in the operations of subsidiaries and other holdings. Operating expenses, excluding holdings, will be kept at their budgeted 2003 level until 2006 and will increase by 1% in 2007 and 2008. This moderate growth presupposes sustained efforts to improve productivity.

Statement of Consolidated Results (\$ millions)						
	2003	2004	2005	2006	2007	2008
Revenue	11,455	11,538	12,306	12,944	13,209	13,815
Operating expenses <i>excl. holdings</i>	2,309	2,428	2,475	2,578	2,682	2,759
	2,092	2,092	2,092	2,092	2,113	2,134
Other expenses <i>incl. budgetary contingency</i>	4,671	4,761	5,087	5,375	5,604	5,859
	–	–	300	400	400	400
Financial expenses	2,743	2,569	2,914	2,956	2,887	3,010
Non-controlling interest	32	30	30	35	36	37
Consolidated net income	1,700	1,750	1,800	2,000	2,000	2,150
Dividends likely to be declared	850	875	900	1,000	1,000	1,075
Return on equity (%)	11.6	11.3	11.0	11.5	10.9	11.1
Interest coverage	1.59	1.57	1.60	1.62	1.57	1.65
Average cost of debt (%)	8.2	7.5	8.5	8.6	8.2	8.2

Other expenses are expected to total \$5.9 billion in 2008, compared with \$4.7 billion in 2003. This increase reflects Hydro-Québec Distribution's energy purchases from private suppliers (TransCanada Energy and wind power contracts, for example) of approximately \$0.4 billion, an increase in amortization expense of \$0.4 billion and a budgetary contingency of \$0.4 billion.

For the 2004–2008 period, Hydro-Québec has added a \$1.5 billion budgetary contingency to its projections to cover variations in runoff; this gives the company a 75% probability over five years of achieving its financial targets.

Financial expenses (including interest, exchange losses and loan guarantee fees) will increase by \$267 million over the period, reaching slightly more than \$3.0 billion in 2008. This increase is the result of cash requirements to finance the company's major investment program over the next five years. With the expected growth in operating income, however, interest coverage will remain at approximately 1.60.

Capital Investment (\$ millions)						
	2004	2005	2006	2007	2008	2004–2008
Hydro-Québec Production	1,631	1,615	2,232	2,394	1,192	9,064
Hydro-Québec TransÉnergie	922	1,098	1,095	975	740	4,830
Hydro-Québec Distribution	734	747	746	699	671	3,597
Other	381	352	294	277	254	1,558
Total	3,668	3,812	4,367	4,345	2,857	19,049

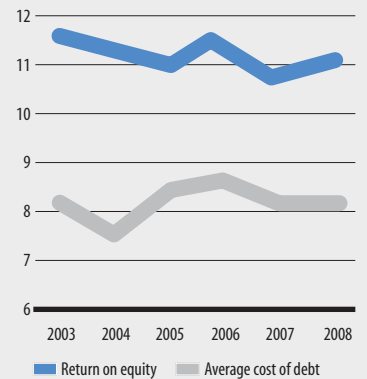
Return on equity will remain relatively stable, because the growth of net income is comparable to that of shareholder's equity. Despite the forecast increase in interest rates, return on equity should remain at approximately 11%, a rate that is higher than the average cost of debt. Dividends likely to be declared are estimated at \$4.9 billion for the 2004–2008 period.

The company also plans to continue developing its international operations and its technologies. In order to limit the risk of capital investment in these holdings, Hydro-Québec should hold no more than 10% of the consolidated value of shareholder's equity. The expected return should reflect the inherent risk of these activities. Total return over the life of the various projects must consider not only the income generated by the projects, but also the potential gain upon disposal of investments.

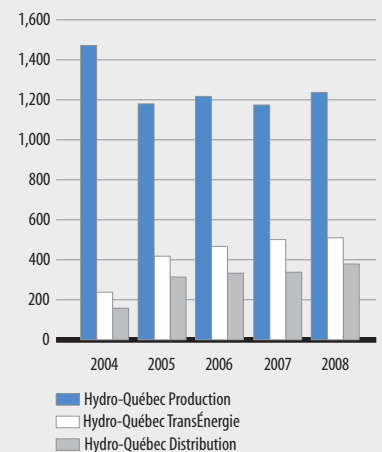
Results by Division

The main contribution to the company's net income comes from Hydro-Québec Production. Its results will decline after 2004, however, reflecting the addition of a budgetary contingency for the last four years of the Plan. This increases the probability of reaching forecast net income as of 2005 to more than 50%, considering the risks to which the division is exposed, especially those related to variations in runoff.

Return on Equity and Average Cost of Debt (%)



Contribution of the Divisions to Net Income (\$ millions)



Contribution of the Divisions (\$ millions)

	2003	2004	2005	2006	2007	2008
Net Income						
Hydro-Québec Production ¹	1,654	1,472	1,180	1,217	1,174	1,237
Hydro-Québec TransÉnergie	297	238	418	467	501	510
Hydro-Québec Distribution	(173)	158	314	333	338	379
Other	(78)	(118)	(112)	(17)	(13)	24
Consolidated net income	1,700	1,750	1,800	2,000	2,000	2,150

1. After budgetary contingency.

Hydro-Québec TransÉnergie will see its income rise significantly in 2005, due to adjustments in transmission rates to compensate for the decrease in point-to-point reservations over the next few years. Without these adjustments, the division would not have sufficient revenue to reach the return authorized by the Régie de l'énergie. This situation explains the low profitability of transmission operations in Québec in 2003 and 2004.

Hydro-Québec Distribution's contribution will increase steadily throughout the period. This improvement can be ascribed to the freeze in operating expenses and to rate increases, which will allow it to maintain its authorized return over the Plan period.

Changes in Financial Position

Changes in Consolidated Financial Position (\$ millions)

	2003	2004	2005	2006	2007	2008
Use of funds						
Capital investment	(3,473)	(3,668)	(3,812)	(4,367)	(4,345)	(2,857)
Redemptions and maturities	(3,023)	(1,693)	(2,452)	(2,151)	(2,121)	(1,412)
Dividends	(763)	(850)	(875)	(900)	(1,000)	(1,000)
	(7,259)	(6,211)	(7,139)	(7,418)	(7,466)	(5,269)
Source of funds						
Operations	3,638	3,841	4,356	4,439	4,638	4,420
Financing ¹	3,621	2,370	2,783	2,979	2,828	849
	7,259	6,211	7,139	7,418	7,466	5,269
Self-financing (%)	47.8	55.8	55.6	54.3	56.3	80.1

1. Including net change in short-term investments and cash equivalents.

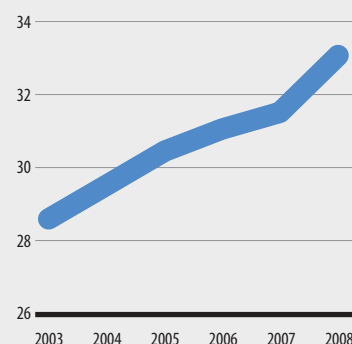
Over the 2004–2008 period, operations will generate \$21.7 billion. These funds, combined with the \$11.8 billion in external financing, will be used to finance \$19.0 billion in capital spending, to repay \$9.8 billion of debt at maturity and to pay dividends.

Despite major capital investments, self-financing will remain at approximately 55%, which is comparable to recent years. In 2008, the low volume of debt coming to maturity and moderate capital spending will raise self-financing to 80%. Thus the increased cash flows from improved financial results will make it possible to reduce the company's reliance on external lenders to meet its financing needs.

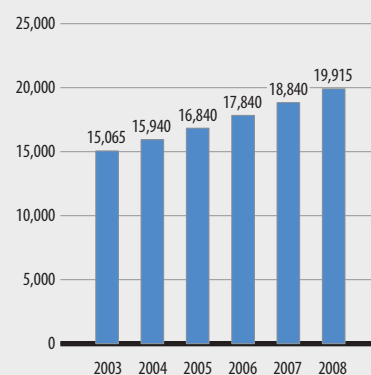
Balance Sheet

By the end of the 2004–2008 period, fixed assets will be valued at \$58 billion and total assets at \$66 billion. About half of all commissionings will be concentrated in generation, with the rest almost entirely divided between transmission and distribution.

Capitalization (%)



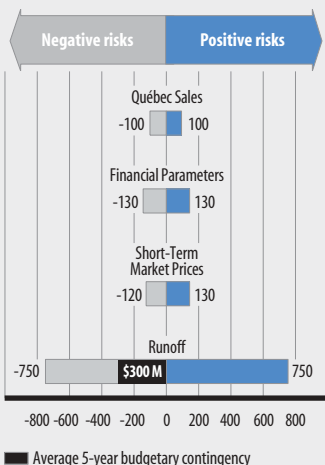
Shareholder's Equity (\$ millions)



Consolidated Balance Sheet (\$ millions)

	2003	2004	2005	2006	2007	2008
Assets						
Fixed assets						
Hydro-Québec Production	24,625	25,500	26,057	27,097	28,087	28,398
Hydro-Québec TransÉnergie	17,596	17,815	18,275	18,716	19,020	19,067
Hydro-Québec Distribution	8,176	8,418	8,670	8,894	9,051	9,143
Other	1,330	1,356	1,339	1,322	1,305	1,270
Total – Net fixed assets	51,727	53,089	54,341	56,029	57,463	57,878
Other assets	6,030	6,019	6,399	7,102	8,054	8,343
Total – Assets	57,757	59,108	60,740	63,131	65,517	66,221
Liabilities						
Total debt	38,019	38,706	39,087	40,269	41,386	40,999
Other liabilities	4,673	4,462	4,813	5,022	5,291	5,307
Total – Liabilities	42,692	43,168	43,900	45,291	46,677	46,306
Shareholder's equity	15,065	15,940	16,840	17,840	18,840	19,915
Liabilities and shareholder's equity	57,757	59,108	60,740	63,131	65,517	66,221
Capitalization (%)	28.5	29.4	30.3	30.9	31.5	32.9

Change in Net Income for 2006 (\$ millions)



Between 2003 and 2008, total debt will increase by \$3.0 billion because of the major capital investment program.

Hydro-Québec's current agreement with its shareholder with regard to the payment of dividends allows the company to keep half its net income. Shareholder's equity will therefore increase by \$4.9 billion to approximately \$20.0 billion by 2008. At the same time, the capitalization rate will rise from 28.5% in 2003 to 32.9% in 2008.

Sensitivity Analysis of Consolidated Net Income Forecast for 2006

A sensitivity analysis of the net income forecast for 2006 provides an estimate of the potential impact of certain business risks on Hydro-Québec.

The results shown in the adjacent figure cover a 68% probability range. For example, an analysis of the risk stemming from variation in financial parameters shows that there is only a 16% chance that negative fluctuations will result in a decline of more than \$130 million in net income, and a 16% chance that such fluctuations, conversely, will result in an increase of more than \$130 million in net income.

The business risks most likely to affect net income are changes in financial parameters, changes in prices on short-term markets and variations in runoff.

Main Economic Parameters (\$ millions)

	2003	2004	2005	2006	2007	2008
Real GDP (Québec) (% change)	2.1	3.2	2.2	2.6	2.5	2.3
CPI (Canada) (% change)	2.9	1.3	1.6	1.5	2.3	2.1
Price of aluminum (US\$/lb)	67.8	68.4	68.5	68.5	68.5	68.5
Exchange rate (C\$/US\$)	0.703	0.731	0.723	0.716	0.711	0.706
90-day interest rate						
Canada (%)	3.1	3.9	4.7	4.7	4.8	4.8
United States (%)	1.1	2.1	3.2	3.7	3.9	4.5
10-year interest rate						
Canada (%)	5.4	5.7	6.2	6.2	6.3	6.4
United States (%)	4.4	5.4	6.7	6.8	6.8	7.1

Risks related to economic parameters, such as fluctuations in interest rates, exchange rates and the price of aluminum, have been managed on an integrated basis for several years now. Hydro-Québec uses derivative instruments to keep the volatility of its financial results within certain limits. These limits are reviewed every year and submitted to the Board of Directors for approval.

Runoff is still the risk with the greatest impact on the company's financial results. In planning its hydroelectric facilities and related reservoirs, therefore, Hydro-Québec has taken variations in runoff into account. Sound reservoir management and short-term transactions allow Hydro-Québec to keep the impact of runoff risk on net income at an acceptable level.

In the same way, judicious reservoir management allows the company to limit the financial impacts of price decreases on external electricity markets or, conversely, to take advantage of opportunities on those markets.

Economic Impact

Sustaining Employment

In addition to the dividends, taxes and loan guarantee fees it pays to the Québec government, Hydro-Québec also makes a significant contribution to Québec's economy through its growth, capital spending and purchases of goods and services.

In each year of the Plan, Hydro-Québec would like to sustain 50,000 person-years of employment in direct and indirect jobs. To achieve this, the company hopes to accelerate its planned capital investments, by speeding up the completion of its hydroelectric development projects.

According to the financial outlook for the 2004–2008 period, Hydro-Québec's activities, excluding its holdings, will help sustain some 220,000 person-years of employment in all regions of Québec.

Jobs Sustained by Hydro-Québec's Activities (in person-years)							
	2003	2004	2005	2006	2007	2008	2004–2008
Jobs related to facilities operations	22,200	22,400	22,000	21,700	21,200	21,200	108,500
Jobs related to capital spending	20,000	21,800	20,400	23,900	21,900	16,000	104,000
Jobs related to commercial programs	200	400	400	300	300	300	1,700
Jobs related to purchases from IPPs	900	1,100	1,100	1,200	1,300	1,300	6,000
Total	43,300	45,700	43,900	47,100	44,700	38,800	220,200

It is estimated that operations alone will sustain 108,500 person-years in direct and indirect jobs, while capital spending will support 104,000 more. The various commercial programs financed by the company will sustain 1,700 person-years, while purchases from independent power producers (IPPs) will contribute 6,000 person-years.

In addition to these jobs, the operations of Hydro-Québec CapiTech and Hydro-Québec IndusTech will help sustain about 900 jobs, many of them highly skilled, in some 30 Québec companies. This number could increase over the Strategic Plan period, especially with the anticipated development of AVESTOR and TM4.

Tax Contribution

For the 2004–2008 period, in addition to more than \$0.9 billion in loan guarantee fees and \$4.9 billion in shareholder dividends, Hydro-Québec will pay \$3.4 billion in taxes to the provincial government and municipalities. The tax on gross revenue, in lieu of real estate tax, will generate \$1.4 billion for the Québec government, while the capital tax will provide \$1.7 billion.

The dividends likely to be declared, taxes and loan guarantee fees paid to the Québec government and municipalities will amount to approximately 95% of the company's net income for the period.

Regional Economic Impact

Hydro-Québec's presence throughout Québec translated into purchases of goods and services worth over \$1.6 billion in 2002 and sustained the equivalent of nearly 12,250 person-years in direct and indirect jobs.

In addition, Hydro-Québec's own employees working across the province also contribute to regional economic growth.

The geographic distribution of these economic impacts within Québec will depend on the specific projects approved and carried out during the *Strategic Plan 2004–2008* period.

Hydro-Québec's purchasing policy is designed to ensure the distribution of purchases throughout Québec, at the most favorable cost to the company.

As an agent of economic development, Hydro-Québec reaffirms its intention to work with representatives of the regions where it operates for the benefit of all Quebecers.

Continuing to affirm the company's presence across Québec, Hydro-Québec's regional offices will partner with stakeholders and cooperate with local communities to ensure that its operations and projects blend in harmoniously with their host communities and contribute to their vitality.

In addition to generating significant economic benefits throughout the province, Hydro-Québec will continue to support numerous worthy causes in education, health care, and social or humanitarian assistance.

