Quarterly Report

Second Quarter 2018

Message from the Chairman of the Board and the President and Chief Executive Officer

Second quarter

Hydro-Québec recorded **net income** of $623 million for the second quarter of 2018, an increase of $264 million compared to $359 million in the same period of 2017.

This marked increase is mainly due to the creation, in June, of a strategic partnership between Hydro-Québec and the multinational company Dana, under which Hydro-Québec sold a 55% interest in its subsidiary TM4 to Dana. The gain from this transaction amounted to $277 million.

On markets outside Québec, Hydro-Québec Production's net electricity exports totaled $349 million, comparable to the figure posted a year earlier. The export volume reached 8.9 TWh, an unprecedented level for a second quarter and a 1.5-TWh increase over the same period in 2017. However, the positive impact of this volume growth was offset by the impact of the lower average export price obtained.

Summary of results for the first six months

For the six months ended June 30, 2018, Hydro-Québec posted **net income** of $2,267 million, a $365-million increase over the $1,902 million recorded in the same period last year.

This increase is primarily due to the sale, during the second quarter, of a 55% interest in its subsidiary TM4, which generated a gain of $277 million.

On markets outside Québec, Hydro-Québec Production's net electricity exports rose by $17 million to $835 million. The first six months of 2018 were marked by a record volume of net exports. Thanks to the solid performance of the company's generating and transmission facilities, net exports totaled 18.7 TWh, or 1.2 TWh more than the previous record, set in the first half of 2017.

On the Québec market, electricity supplies provided by Hydro-Québec Production to Hydro-Québec Distribution increased by $68 million compared to the same period in 2017. This growth is partly due to a larger volume of peak supplies, given the milder temperatures during the first quarter last year.

Consolidated results for the first six months

Revenue totaled $7,798 million, compared to $7,165 million in the first half of 2017. Revenue from electricity sales in Québec amounted to $6,340 million, or $167 million more than last year, because of two main factors. First, temperatures had a positive impact on sales volume. Whereas winter 2016–2017 had been slightly milder than normal, winter 2017–2018 saw near-normal temperatures; in addition, temperatures in April 2018 were 3°C below climate normals. Second, baseload demand grew in both the residential and the commercial and institutional sectors. Revenue from electricity sales on markets outside Québec was $904 million, compared to $840 million in 2017. Other revenue rose by $402 million to $554 million, essentially because of the recognition of the gain on the partial sale of TM4 as well as the difference in the net amounts that Hydro-Québec may recover from customers or must pay to them, primarily in connection with revenue variances related to climate conditions and variances in electricity supply costs.

Total expenditure amounted to $4,219 million, compared to $4,031 million in 2017. The increase is mainly the result of a $119-million rise in Hydro-Québec Distribution's electricity purchases from third parties, due in part to the commissioning of new wind farms.

Financial expenses totaled $1,312 million in 2018, or $80 million more than the $1,232 million recorded in 2017. On the one hand, interest on debt securities rose by $67 million, mainly because of the impact of the 2017 and 2018 borrowing programs and higher interest rates. On the other hand, capitalized financial expenses decreased by $32 million, essentially as a result of the commissioning of Romaine-3 generating station in September 2017.

Segmented results for the first six months

Generation

Hydro-Québec Production posted net income of $1,186 million, a $28-million increase compared to $1,158 million in the first half of 2017. Net electricity exports totaled 18.7 TWh for $835 million, or $17 million more than the $818 million recorded last year. Net electricity sales to Hydro-Québec Distribution rose by $68 million, partly on account of the higher volume of electricity supplies during peak demand periods. Financial expenses increased by $37 million, essentially because of a reduction in capitalized financial expenses following the commissioning of Romaine-3 generating station in September 2017.

Transmission

Hydro-Québec TransÉnergie's net income was $345 million in 2018, comparable to the $355 million posted in the first six months of 2017.

Distribution

Hydro-Québec Distribution recorded net income of $475 million, compared to $390 million in the same period in 2017. On the one hand, revenue grew by $321 million over last year. This is mainly because of a $167-million increase in electricity sales in Québec, due to temperature variances and higher baseload demand, as well as a $116-million difference in the net amounts that Hydro-Québec may recover from customers or must pay to them, primarily in connection with revenue variances related to climate conditions and variances in electricity supply costs. On the other hand, electricity purchases, the related transmission costs and fuel purchases rose by $252 million. More specifically, supplies from Hydro-Québec Production increased by $68 million, while electricity purchases from third parties increased by $119 million, partly because of the commissioning of new wind farms.

Construction

The Construction segment includes activities related to the design and execution of construction and refurbishment projects involving power generation and transmission facilities. These projects are carried out by Hydro-Québec Innovation, équipement et services partagés and by Société d'énergie de la Baie James (SEBJ).

The volume of activity in this segment totaled $858 million, compared to $1,000 million a year earlier. The main projects under way for Hydro-Québec Production include ongoing construction of the Romaine hydroelectric complex and the refurbishment of various structures at Beauharnois generating station. The division also started refurbishing a fourth generating unit at Robert-Bourassa generating station. Work in progress for Hydro-Québec TransÉnergie includes the 735-kV Chamouchouane–Bout-de-l'Île project, as well as various projects stemming from continued investment in asset reliability and sustainment.

Investment

During the first six months of 2018, Hydro-Québec invested $1,509 million in property, plant and equipment and intangible assets, compared to $1,536 million in the same period last year.

A large part of Hydro-Québec Production's investments was allocated to ongoing construction of the Romaine complex. At the same time, the division continued investing to ensure the long-term operability of its facilities and optimize their output. For instance, refurbishment is under way at Robert-Bourassa and Beauharnois generating stations.

Hydro-Québec TransÉnergie allocated part of its investments to erecting transmission lines, in particular some 400 km of lines that will connect Chamouchouane substation to the Montréal metropolitan loop as part of the 735-kV Chamouchouane–Bout-de-l'Île project. Work also went ahead on the integration of wind farms built in response to Hydro-Québec Distribution's calls for tenders, the construction of Judith-Jasmin substation and the connection of the Romaine complex as part of the project to expand the transmission system in the Minganie region. In addition, the division continued to upgrade and modernize its facilities to ensure the reliability and long-term operability of its transmission assets and enhance service quality. An example of this is the ongoing work on the architecture development plan for the 315-kV system on the island of Montréal.

Hydro-Québec Distribution kept up investments to handle the growth of its customer base, as well as to maintain and improve the quality of its facilities. Its growth projects include connecting Judith-Jasmin substation to the distribution system.

Michael D. Penner

Chairman of the Board

Éric Martel

President and
Chief Executive Officer

September 7, 2018

CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

CONSOLIDATED STATEMENTS OF OPERATIONS

In millions of Canadian dollars (unaudited)		Three months ended June 30		Six months ended June 30	
	Notes	**2018**	2017	**2018**	2017
Revenue	6, 12	**3,291**	2,908	**7,798**	7,165
Expenditure					
Operations		**705**	670	**1,402**	1,339
Other components of employee future benefit cost	9	**(85)**	(83)	**(170)**	(165)
Electricity and fuel purchases		**496**	448	**1,134**	1,017
Depreciation and amortization	4	**654**	654	**1,304**	1,295
Taxes		**244**	245	**549**	545
		2,014	1,934	**4,219**	4,031
Income before financial expenses		**1,277**	974	**3,579**	3,134
Financial expenses	5	**654**	615	**1,312**	1,232
Net income		**623**	359	**2,267**	1,902

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

In millions of Canadian dollars (unaudited)		Three months ended June 30		Six months ended June 30	
	Notes	**2018**	2017	**2018**	2017
Net income		**623**	359	**2,267**	1,902
Other comprehensive income	10				
Net change in items designated as cash flow hedges	7	**(120)**	195	**70**	63
Net change in employee future benefits		**29**	24	**59**	49
Translation differences in financial statements of foreign operations		**1**	–	**2**	(2)
		(90)	219	**131**	110
Comprehensive income		**533**	578	**2,398**	2,012

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

In millions of Canadian dollars (unaudited)	Notes	As at June 30, 2018	As at December 31, 2017
ASSETS			
Current assets			
Cash and cash equivalents		**2,555**	537
Short-term investments		**782**	1,112
Accounts receivable and other receivables		**2,355**	2,486
Derivative instruments	7	**68**	69
Regulatory assets		**123**	124
Materials, fuel and supplies		**235**	228
		6,118	4,556
Property, plant and equipment		**64,309**	63,990
Intangible assets		**865**	871
Investments	6	**1,023**	890
Derivative instruments	7	**62**	19
Regulatory assets		**4,601**	4,717
Other assets		**744**	687
		77,722	75,730
LIABILITIES			
Current liabilities			
Borrowings		**1,483**	8
Accounts payable and accrued liabilities		**2,070**	2,508
Dividend payable		**–**	2,135
Accrued interest		**908**	895
Asset retirement obligations		**71**	65
Derivative instruments	7	**34**	187
Current portion of long-term debt	7	**2,200**	1,183
		6,766	6,981
Long-term debt	7	**43,861**	43,825
Asset retirement obligations		**801**	799
Derivative instruments	7	**31**	22
Regulatory liabilities		**360**	366
Other liabilities		**3,517**	3,731
Perpetual debt	7	**264**	251
		55,600	55,975
EQUITY			
Share capital		**4,374**	4,374
Retained earnings		**20,210**	17,972
Accumulated other comprehensive income	10	**(2,462)**	(2,591)
		22,122	19,755
		77,722	75,730
Contingencies	11		

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board of Directors,

/s/ **Michelle Cormier**
Chair of the Audit Committee

/s/ **Michael D. Penner**
Chairman of the Board

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

In millions of Canadian dollars (unaudited)

Six months ended June 30

	Notes	Share capital	Retained earnings	Accumulated other comprehensive income	Total equity
Balance as at December 31, 2017		**4,374**	**17,972**	**(2,591)**	**19,755**
Adjustments related to the adoption of a change in accounting policy	2	**–**	**(29)**	**(2)**	**(31)**
Net income		**–**	**2,267**	**–**	**2,267**
Other comprehensive income	10	**–**	**–**	**131**	**131**
Balance as at June 30, 2018		**4,374**	**20,210**	**(2,462)**	**22,122**
Balance as at December 31, 2016		4,374	17,261	(1,931)	19,704
Net income		–	1,902	–	1,902
Other comprehensive income	10	–	–	110	110
Balance as at June 30, 2017		4,374	19,163	(1,821)	21,716

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

In millions of Canadian dollars (unaudited)	Notes	Three months ended June 30 2018	Three months ended June 30 2017	Six months ended June 30 2018	Six months ended June 30 2017
Operating activities					
Net income		**623**	359	**2,267**	1,902
Adjustments to determine net cash flows from operating activities					
Depreciation and amortization	4	**654**	654	**1,304**	1,295
Amortization of premiums, discounts and issue expenses related to debt securities		**49**	46	**99**	92
Deficit of net cost recognized with respect to amounts paid for employee future benefits		**(45)**	(65)	**(87)**	(113)
Gain on partial sale of a subsidiary	6	**(277)**	–	**(277)**	–
Other		**133**	128	**76**	233
Regulatory assets and liabilities		**(123)**	(131)	**(129)**	(134)
Change in non-cash working capital items	8	**1,024**	1,124	**(310)**	(386)
		2,038	2,115	**2,943**	2,889
Investing activities					
Additions to property, plant and equipment		**(786)**	(859)	**(1,459)**	(1,492)
Additions to intangible assets		**(26)**	(25)	**(50)**	(44)
Partial sale of a subsidiary, net of cash disposed		**160**	–	**160**	–
Net change in short-term investments and sinking fund		**(316)**	(199)	**294**	652
Other		**7**	3	**12**	5
		(961)	(1,080)	**(1,043)**	(879)
Financing activities					
Issuance of long-term debt		**(23)**	–	**590**	39
Repayment of long-term debt		**(13)**	(1,323)	**(43)**	(1,390)
Cash receipts arising from credit risk management		**967**	1,507	**1,932**	3,259
Cash payments arising from credit risk management		**(776)**	(1,431)	**(1,686)**	(3,315)
Net change in borrowings		**(180)**	(1,054)	**1,441**	1,120
Dividend paid		**–**	–	**(2,135)**	(2,146)
Other		**1**	(8)	**11**	(12)
		(24)	(2,309)	**110**	(2,445)
Foreign currency effect on cash and cash equivalents		**1**	(9)	**8**	(10)
Net change in cash and cash equivalents		**1,054**	(1,283)	**2,018**	(445)
Cash and cash equivalents, beginning of period		**1,501**	2,081	**537**	1,243
Cash and cash equivalents, end of period		**2,555**	798	**2,555**	798
Supplementary cash flow information	8				

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

For the three- and six-month periods ended June 30, 2018 and 2017

Amounts in tables are in millions of Canadian dollars, unless otherwise indicated.

Note 1 Basis of Presentation

Hydro-Québec's consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP").

These quarterly consolidated financial statements, including these notes, do not contain all the required information regarding annual consolidated financial statements and should therefore be read in conjunction with the consolidated financial statements and accompanying notes in Hydro-Québec's *Annual Report 2017*.

The accounting policies used to prepare the quarterly consolidated financial statements are consistent with those presented in Hydro-Québec's *Annual Report 2017*, except for the recent changes.

Management is of the opinion that these quarterly consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hydro-Québec.

Hydro-Québec's quarterly results are not necessarily indicative of results for the year on account of seasonal temperature fluctuations. Because of higher electricity demand during winter months, revenue from electricity sales in Québec is higher during the first and fourth quarters.

Management has reviewed events occurring until September 7, 2018, the date of approval of these quarterly consolidated financial statements by the Board of Directors, to determine whether circumstances warranted consideration of events subsequent to the balance sheet date.

Note 2 Changes to Accounting Policies

RECENT CHANGES

Hedge accounting

On January 1, 2018, Hydro-Québec early adopted Accounting Standards Update ("ASU") 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, issued by the Financial Accounting Standards Board (the "FASB"). This ASU amends the requirements related to hedging relationships in order to simplify the application of hedge accounting and to improve the transparency of information provided in the financial statements regarding an entity's risk management activities.

ASU 2017-12 was applied on a modified retrospective basis. For cash flow hedging relationships, its adoption led to the non-recognition of the ineffective portion of existing relationships in results. As at January 1, 2018, this change resulted in a $2-million increase in retained earnings and an equivalent decrease in other comprehensive income. Moreover, the ASU provides for simplified measurement of existing fair value hedges, which translated into a $31-million increase in long-term debt and an equivalent decrease in retained earnings. Prior-year figures have not been restated.

Statement of cash flows

On January 1, 2018, Hydro-Québec adopted ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU clarifies how certain items are presented and classified in the statement of cash flows. It was applied on a full retrospective basis and did not have an impact on Hydro-Québec's consolidated financial statements.

Financial instruments

On January 1, 2018, Hydro-Québec adopted ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU provides guidance on the recognition and measurement of financial assets and financial liabilities. It was applied on a modified retrospective basis and did not have an impact on Hydro-Québec's consolidated financial statements.

Revenue

On January 1, 2018, Hydro-Québec adopted Accounting Standards Codification ("ASC") 606, *Revenue from Contracts with Customers*. This ASC provides revenue recognition guidance to apply when transferring goods and services to customers, for an amount that reflects the payment that the entity expects to receive in exchange for those goods and services.

Note 2 Changes to Accounting Policies (continued)

ASC 606 was applied on a modified retrospective basis to contracts not yet completed as at January 1, 2018. It has not had any significant impact on Hydro-Québec's consolidated financial statements.

However, the revenue accounting policy was amended as follows:

Hydro-Québec supplies the Québec market with electricity and also sells power on wholesale markets in Canada and the United States. Substantially all revenue from ordinary activities is derived from electricity sales contracts made with customers. These sales are recognized over time, based on the electricity delivered and the amount that Hydro-Québec is entitled to bill customers in accordance with regulated rates or contractual provisions.

STANDARDS ISSUED BUT NOT YET ADOPTED

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU provides guidance on lease definition, recognition and presentation and requires, in particular, the recognition of assets and liabilities by lessees for all operating and finance leases with a term of more than 12 months. It will apply on a modified retrospective basis to interim and annual financial statements for annual periods beginning on or after January 1, 2019. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements.

In January 2018, the FASB issued ASU 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842.* This ASU provides a practical expedient to not evaluate under ASC 842, *Leases,* existing or expired easement agreements as at the date this standard is adopted, namely January 1, 2019, and which were not previously accounted for as leases under ASC 840, *Leases*. Furthermore, it specifies that easement agreements must be analyzed under ASC 842 to determine if they meet the definition of a lease before applying the guidance set forth in ASC 350, *Intangibles—Goodwill and Other*. It will be applied on a modified retrospective basis to interim and annual financial statements for annual periods beginning on or after January 1, 2019. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements.

Financial instruments

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* This ASU provides new guidance on the impairment of financial assets that are not accounted for at fair value through net income. It will be applied on a modified retrospective basis to the financial statements for interim and annual periods beginning on or after January 1, 2021. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements.

Note 3 Regulation

DISTRIBUTION

In decisions D-2018-025 of March 7, 2018, and D-2018-030 of March 23, 2018, the Régie de l'énergie (the "Régie") authorized an increase of 0.3% in all Hydro-Québec electricity rates except Rate L, which remained unchanged. The new rates are effective as of April 1, 2018. The authorized return on the rate base was set at 7.08%, assuming a capitalization with 35% equity.

The Régie also authorized the Distributor to include in its 2018–2019 rates a credit amount of $40 million for variances in electricity supply costs for 2016 and 2017, a debit amount of $47 million for revenue variances related to climate conditions in 2016 and 2017, and a credit amount of $2 million corresponding to the balance, as at December 31, 2017, of the variance account for amendments to ASC 715, *Compensation—Retirement Benefits.*

Lastly, the Régie authorized the Distributor to create a non-rate-base, interest-bearing variance account to record certain costs incurred under the Demand Response Program for business customers. As at June 30, 2018, an amount of $3 million had been recognized in this account.

TRANSMISSION

In decisions D-2018-021 of March 6, 2018, and D-2018-035 of March 28, 2018, the Régie set Hydro-Québec's power transmission rates for 2018. The authorized return on the rate base was set at 7.0%, assuming a capitalization with 30% equity.

The Régie also authorized the Transmission Provider to include in its 2018 rates a credit amount of $34 million from the variance account for amendments to ASC 715, *Compensation—Retirement Benefits*.

Note 4 Depreciation and Amortization

	Three months ended June 30		Six months ended June 30	
	2018	2017	**2018**	2017
Property, plant and equipment	**581**	545	**1,156**	1,095
Intangible assets	**27**	45	**60**	89
Regulatory assets and liabilities	**41**	45	**83**	89
Retirement of capital assets	**5**	19	**5**	22
	654	654	**1,304**	1,295

Note 5 Financial Expenses

	Three months ended June 30		Six months ended June 30	
	2018	2017	**2018**	2017
Interest on debt securities	**666**	627	**1,320**	1,253
Net exchange (gain) loss	**(4)**	2	**(6)**	4
Guarantee fees related to debt securities[a]	**53**	55	**107**	109
	715	684	**1,421**	1,366
Less				
Capitalized financial expenses	**44**	58	**79**	111
Net investment income	**17**	11	**30**	23
	61	69	**109**	134
	654	615	**1,312**	1,232

a) Guarantee fees related to debt securities are charged at a rate of 0.5% and are paid to the Québec government.

Note 6 Investments

On June 22, 2018, Hydro-Québec sold 55% of the shares of its subsidiary TM4 Inc. (“TM4”) to an independent third party for a cash consideration of $165 million.

As a result of this transaction, Hydro-Québec ceased to consolidate TM4, and the 45% interest retained was measured at fair value.

A $277-million gain on the partial sale of TM4, including $125 million resulting from the fair value measurement of the interest retained, was recognized in Revenue.

The investment in TM4 is now accounted for using the equity method.

Note 7 Financial Instruments

In the course of its operations, Hydro-Québec carries out transactions that expose it to certain financial risks, such as market, liquidity and credit risk. Exposure to such risks and the impact on results are reduced through careful monitoring and implementation of strategies that include the use of derivative instruments.

MARKET RISK

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market prices. Hydro-Québec is exposed to three main types of market risk: currency risk, interest rate risk and risk associated with energy and aluminum prices. Active integrated management of these three types of risk aims to limit exposure to each risk and reduce their overall impact on results.

MANAGEMENT OF LONG-TERM RISK

Management of risk associated with debt

Currency risk and interest rate risk – Hydro-Québec uses forward contracts and currency swaps to manage the currency risk associated with long-term debt and perpetual debt, as well as forward contracts and interest rate swaps to modify long-term exposure to interest rate risk. When designated as hedging items, these derivative instruments are recognized as cash flow hedges or fair value hedges, depending on the risk hedged. The impact on results of foreign currency hedging transactions and those associated with debt interest rates is recognized in Financial expenses.

The following table shows the notional amounts, expressed in Canadian dollars and foreign currencies, of forward contracts and swaps used to manage long-term risk:

	As at June 30, 2018[a]	As at December 31, 2017[a]
Forward contracts		
Canadian dollars	**(500)**	(70)
U.S. dollars	**203**	202
Swaps		
Canadian dollars	**(6,925)**	(6,938)
U.S. dollars	**5,730**	5,730

a) Figures in parentheses represent amounts to be paid.

MANAGEMENT OF SHORT-TERM RISK

Currency risk – Hydro-Québec uses forward contracts to manage its foreign currency risk exposure over the short term. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact of currency risk hedging transactions on results is recognized in the line items affected by the hedged item, namely Revenue, Electricity and fuel purchases, or Financial expenses. In this context, Hydro-Québec has traded foreign currency sales and purchase contracts for which open positions as at June 30, 2018, totaled a notional amount of US$2,030 million and US$1,130 million, respectively (US$885 million for sales contracts and nil for purchase contracts as at December 31, 2017).

Interest rate risk – Hydro-Québec uses forward rate agreements and interest rate swaps to manage short-term interest rate risk. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact on results of transactions to hedge short-term interest rate risk is recognized in the line item affected by the hedged item, namely Financial expenses.

Price risk – Hydro-Québec uses mainly commodity futures and swaps to manage risk resulting from fluctuations in energy and aluminum prices. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact on results of transactions to hedge the risk related to energy and aluminum prices is recognized in the line items affected by the hedged item, namely Revenue or Electricity and fuel purchases. In this context, Hydro-Québec has traded electricity futures and swaps for which open positions as at June 30, 2018, totaled 25.9 TWh (22.5 TWh as at December 31, 2017), natural gas futures for which open positions as at June 30, 2018, totaled 1.3 million MMBtu (0.5 million MMBtu as at December 31, 2017), petroleum product swaps for which open positions as at June 30, 2018, totaled 14.4 million litres (no open positions as at December 31, 2017), as well as aluminum swaps for which open positions as at June 30, 2018, totaled 353,400 tonnes (410,125 tonnes as at December 31, 2017).

Note 7 Financial Instruments (continued)

FAIR VALUE

FAIR VALUE OF DERIVATIVE INSTRUMENTS

The following tables present the fair value of derivative instruments by type and depending on whether they are designated as fair value hedges or cash flow hedges, or not designated as hedges:

	As at June 30, 2018			
	Derivatives designated as fair value hedges	Derivatives designated as cash flow hedges	Derivatives not designated as hedges[a]	Gross amounts of derivatives recognized[b]
Assets				
Contracts – Currency risk	–	959	36	**995**
Contracts – Interest rate risk	376	3	3	**382**
Contracts – Price risk	–	37	54	**91**
	376	999	93	**1,468**
Liabilities				
Contracts – Currency risk	–	(206)	(199)	**(405)**
Contracts – Interest rate risk	–	–	–	**–**
Contracts – Price risk	–	(81)	(24)	**(105)**
	–	(287)	(223)	**(510)**
Total	376	712	(130)	**958**

	As at December 31, 2017			
	Derivatives designated as fair value hedges	Derivatives designated as cash flow hedges	Derivatives not designated as hedges[a]	Gross amounts of derivatives recognized[b]
Assets				
Contracts – Currency risk	–	769	51	820
Contracts – Interest rate risk	420	3	2	425
Contracts – Price risk	–	8	61	69
	420	780	114	1,314
Liabilities				
Contracts – Currency risk	–	(266)	(251)	(517)
Contracts – Interest rate risk	–	–	–	–
Contracts – Price risk	–	(267)	(24)	(291)
	–	(533)	(275)	(808)
Total	420	247	(161)	506

a) These derivative instruments are mainly traded as part of Hydro-Québec's risk management. As at June 30, 2018, $(197) million was in consideration of amounts received or disbursed [$(210) million as at December 31, 2017] with respect to agreements to limit the market value of the main portfolios of derivative instruments. These agreements arise from frameworks applied by Hydro-Québec to reduce its credit risk exposure and limit risk concentration.

b) Fair value measurements of derivative instruments are Level 2 measurements. These measurements are obtained by discounting future cash flows, which are estimated on the basis of the spot rates, forward rates or forward prices (foreign exchange rates, interest rates, and energy or aluminum prices) in effect on the balance sheet date and take into account the credit risk assessment. The valuation techniques make use of observable market data.

Note 7 Financial Instruments (continued)

The impact of offsetting derivative instruments is presented in the table below:

	As at June 30, 2018				As at December 31, 2017			
	Gross amounts of derivatives recognized	Gross amounts offset[a]	Cash (received) paid as collateral[b]	Net amounts presented on the balance sheet	Gross amounts of derivatives recognized	Gross amounts offset[a]	Cash (received) paid as collateral[b]	Net amounts presented on the balance sheet
Assets								
Current	111	(43)	–	**68**	143	(68)	(6)	69
Long-term	1,357	(402)	(893)	**62**	1,171	(527)	(625)	19
	1,468	(445)	(893)	**130**	1,314	(595)	(631)	88
Liabilities								
Current	(309)	275	–	**(34)**	(509)	321	1	(187)
Long-term	(201)	170	–	**(31)**	(299)	274	3	(22)
	(510)	445	–	**(65)**	(808)	595	4	(209)
Total	958	–	(893)	**65**	506	–	(627)	(121)

a) The gross amounts of derivatives offset are related to contracts traded according to International Swaps and Derivatives Association ("ISDA") guidelines and constituting enforceable master netting arrangements. Such master netting arrangements apply to all derivative instrument contracts traded over the counter.

b) Cash amounts offset are amounts received or paid under collateral exchange agreements signed in compliance with ISDA guidelines.

Moreover, although certain derivatives cannot be offset for lack of enforceable master netting arrangements, margin calls may result in amounts received from or paid to clearing agents, based on the fair value of the instruments concerned. As at June 30, 2018, $40 million receivable from clearing agents in consideration of net cash payments was included in Accounts receivable and other receivables, under Current assets on the balance sheet ($111 million as at December 31, 2017).

Note 7 Financial Instruments (continued)

The impact of derivative instruments on results and other comprehensive income is presented in the tables below. It should be noted that most derivative instruments traded are designated as cash flow hedges or fair value hedges and therefore reduce the volatility of results. Derivative instruments which are not designated as hedges, but which nonetheless provide an economic hedge for at-risk opposite positions, also reduce the volatility of results. The sensitivity of results is thus limited to net exposure to unhedged risks.

				Three months ended June 30, 2018
	Losses (gains) on derivatives designated as fair value hedges	Losses (gains) on derivatives designated as cash flow hedges		Losses (gains) on derivatives not designated as hedges
	Recognized in results	Recognized in Other comprehensive income[a]	Reclassified from Other comprehensive income to results	Recognized in results
Contracts – Currency risk	–	(123)	(137)[b]	(38)
Contracts – Interest rate risk	16	5	1[c]	1
Contracts – Price risk	–	125	23[d]	20
	16[c, e]	**7**	**(113)[e]**	**(17)[e, f]**
Impact of hedged items on results	**(15)**		**117**	**39**

					Three months ended June 30, 2017
	Losses (gains) on derivatives designated as fair value hedges	Losses (gains) on derivatives designated as cash flow hedges			Losses (gains) on derivatives not designated as hedges
	Recognized in results	Effective portion recognized in Other comprehensive income	Ineffective portion recognized in results	Effective portion reclassified from Other comprehensive income to results	Recognized in results
Contracts – Currency risk	–	72	–	192[b]	(1)
Contracts – Interest rate risk	40	(4)	–	1[c]	(2)
Contracts – Price risk	–	(90)	7[d]	(20)[d]	(44)
	40[c, e]	(22)	7	173[e]	(47)[e, f]
Impact of hedged items on results	(39)			(173)	(5)

a) Following the adoption of ASU 2017-12, the amounts for 2018 include the ineffective portion of the hedging relationships previously presented in results.

b) In 2018, $3 million was recognized in Revenue (nil in 2017), and $(140) million in Financial expenses ($192 million in 2017).

c) These amounts were recognized in Financial expenses.

d) These amounts were recognized in Revenue.

e) In 2018, the items Revenue, Electricity and fuel purchases, and Financial expenses totaled $3,291 million, $496 million and $654 million, respectively ($2,908 million, $448 million and $615 million in 2017).

f) These instruments are essentially related to integrated risk management transactions. The impact of these instruments on results is recognized in the line items affected by the managed risk. Therefore, in 2018, $31 million was recognized in Revenue [$(38) million in 2017], $(7) million in Electricity and fuel purchases [$(8) million in 2017], and $(41) million in Financial expenses [$(1) million in 2017].

Note 7 Financial Instruments (continued)

	Losses (gains) on derivatives designated as fair value hedges	Losses (gains) on derivatives designated as cash flow hedges		Losses (gains) on derivatives not designated as hedges
				Six months ended June 30, 2018
	Recognized in results	Recognized in Other comprehensive income[a]	Reclassified from Other comprehensive income to results	Recognized in results
Contracts – Currency risk	–	(246)	(371)[b]	(92)
Contracts – Interest rate risk	38	23	2[c]	2
Contracts – Price risk	–	(99)	117[d]	–
	38[c, e]	**(322)**	**(252)**[e]	**(90)**[e, f]
Impact of hedged items on results	**(35)**		**263**	**92**

	Losses (gains) on derivatives designated as fair value hedges	Losses (gains) on derivatives designated as cash flow hedges			Losses (gains) on derivatives not designated as hedges
					Six months ended June 30, 2017
	Recognized in results	Effective portion recognized in Other comprehensive income	Ineffective portion recognized in results	Effective portion reclassified from Other comprehensive income to results	Recognized in results
Contracts – Currency risk	–	187	(1)[b]	241[b]	(20)
Contracts – Interest rate risk	43	(4)	–	2[c]	(2)
Contracts – Price risk	–	(115)	11[d]	(112)[d]	(46)
	43[c, e]	68	10	131[e]	(68)[e, f]
Impact of hedged items on results	(42)			(131)	12

a) Following the adoption of ASU 2017-12, the amounts for 2018 include the ineffective portion of the hedging relationships previously presented in results.

b) In 2018, $(10) million was recognized in Revenue [$(10) million in 2017], and $(361) million in Financial expenses ($250 million in 2017).

c) These amounts were recognized in Financial expenses.

d) These amounts were recognized in Revenue.

e) In 2018, the items Revenue, Electricity and fuel purchases, and Financial expenses totaled $7,798 million, $1,134 million and $1,312 million, respectively ($7,165 million, $1,017 million and $1,232 million in 2017).

f) These instruments are essentially related to integrated risk management transactions. The impact of these instruments on results is recognized in the line items affected by the managed risk. Therefore, in 2018, $16 million was recognized in Revenue [$(47) million in 2017], $(12) million in Electricity and fuel purchases [$(3) million in 2017], and $(94) million in Financial expenses [$(18) million in 2017].

Note 7 Financial Instruments (continued)

During the first six months of 2018, Hydro-Québec reclassified a net loss of $11 million from Accumulated other comprehensive income to results after having discontinued cash flow hedges (nil for the first six months of 2017).

As at June 30, 2018, the net loss presented in Accumulated other comprehensive income that would be reclassified to results in the next 12 months was estimated at $61 million (net gain of $33 million as at June 30, 2017).

As at June 30, 2018 and 2017, the maximum period during which Hydro-Québec hedged its exposure to the variability of cash flows related to anticipated transactions was three years.

FAIR VALUE OF OTHER FINANCIAL INSTRUMENTS

Fair value measurements for other financial instruments are Level 2 measurements. Fair value is obtained by discounting future cash flows, based on rates observed on the balance sheet date for similar instruments traded on capital markets.

The fair value of cash equivalents, receivables – accounts receivable, other receivables and financial liabilities approximates their carrying amount because of the short-term nature of these financial instruments, except in the case of the items presented in the table below:

	As at June 30, 2018		As at December 31, 2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt[a]	**46,061**[b]	**61,352**	45,008[b]	61,271
Perpetual debt	**264**	**239**	251	204

a) Including the current portion.

b) This includes an amount of $2,001 million ($1,829 million in 2017) for debts subject to a fair value hedge, which resulted in an adjustment of $352 million in connection with the hedged risk ($359 million in 2017) for existing hedging relationships and of $(98) million [$(100) million in 2017] for relationships terminated by Hydro-Québec.

ACCOUNTS RECEIVABLE AND OTHER RECEIVABLES

As at June 30, 2018, accounts receivable and other receivables included $1,754 million ($2,030 million as at January 1, 2018) from contracts entered into with customers, of which unbilled electricity deliveries totaled $779 million ($1,496 million as at December 31, 2017).

Note 8 Supplementary Cash Flow Information

	Three months ended June 30		Six months ended June 30	
	2018	2017	**2018**	2017
Change in non-cash working capital items				
Accounts receivable and other receivables	**833**	801	**140**	(24)
Materials, fuel and supplies	**(1)**	13	**(12)**	–
Accounts payable and accrued liabilities	**(212)**	(64)	**(428)**	(324)
Accrued interest	**404**	374	**(10)**	(38)
	1,024	1,124	**(310)**	(386)
Investing activities not affecting cash				
Increase in property, plant and equipment	**15**	17	**32**	32
Interest paid	**158**	155	**1,095**	1,053

Note 9 Employee Future Benefits

	Three months ended June 30			
	Pension Plan		Other plans	
	2018	2017	**2018**	2017
Current service cost	**126**	108	**12**	11
Other components of employee future benefit cost				
Interest on obligations	**209**	198	**13**	13
Expected return on plan assets	**(383)**	(356)	**(1)**	(1)
Amortization of net actuarial loss	**69**	56	**8**	6
Amortization of past service costs (credits)	**1**	2	**(1)**	(1)
	(104)	(100)	**19**	17
Net cost recognized	**22**	8	**31**	28

	Six months ended June 30			
	Pension Plan		Other plans	
	2018	2017	**2018**	2017
Current service cost	**252**	215	**24**	22
Other components of employee future benefit cost				
Interest on obligations	**418**	396	**26**	25
Expected return on plan assets	**(766)**	(711)	**(2)**	(2)
Amortization of net actuarial loss	**138**	111	**15**	13
Amortization of past service costs (credits)	**3**	5	**(2)**	(2)
	(207)	(199)	**37**	34
Net cost recognized	**45**	16	**61**	56

Note 10 Accumulated Other Comprehensive Income

		Six months ended June 30, 2018			
	Note	Cash flow hedges	Employee future benefits	Translation differences	Accumulated other comprehensive income
Balance as at December 31, 2017		(406)	(2,186)	1	**(2,591)**
Adjustments related to the adoption of a change in accounting policy	2	(2)	–	–	**(2)**
		(408)	(2,186)	1	**(2,593)**
Other comprehensive income before reclassifications		322	–	2	**324**
Amounts reclassified to results		(252)	59	–	**(193)**
Other comprehensive income		70	59[a]	2	**131**
Balance as at June 30, 2018		(338)	(2,127)	3	**(2,462)**

	Six months ended June 30, 2017			
	Cash flow hedges	Employee future benefits	Translation differences	Accumulated other comprehensive income
Balance as at December 31, 2016	(135)	(1,799)	3	(1,931)
Other comprehensive income before reclassifications	(68)	–	(2)	(70)
Amounts reclassified to results	131	49	–	180
Other comprehensive income	63	49[a]	(2)	110
Balance as at June 30, 2017	(72)	(1,750)	1	(1,821)

a) Other comprehensive income includes the change in the employee future benefit regulatory asset, which totaled $(95) million as at June 30, 2018 [$(78) million as at June 30, 2017].

Note 11 Contingencies

GUARANTEES

In accordance with the terms and conditions of certain debt securities issued outside Canada, Hydro-Québec has undertaken to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. Hydro-Québec cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, Hydro-Québec has the option of redeeming most of the securities in question. As at June 30, 2018, the amortized cost of the long-term debts concerned was $3,303 million.

LITIGATION

In the normal course of its development and operating activities, Hydro-Québec is sometimes party to claims and legal proceedings. Management is of the opinion that an adequate provision has been made for these legal actions. Consequently, it does not foresee any significant adverse effect of such contingent liabilities on Hydro-Québec's consolidated operating results or financial position.

Among other ongoing actions, some Indigenous communities have instituted proceedings against the governments of Canada and Québec, as well as against Hydro-Québec, based on demands concerning their ancestral rights. In particular, the Innus of Uashat mak Mani-Utenam are demanding $1.5 billion in damages resulting from various operations carried out on land they claim as their own. Hydro-Québec is challenging the legitimacy of these claims. The file has been inactive since March 2016, even though the Court did not issue a stay order. It could, however, be reactivated at any time by the Court or the plaintiff's lawyer.

As well, in November 2006, the Innus of Pessamit reactivated a case instituted in 1998 aimed at obtaining, among other things, the recognition of ancestral rights related to Québec lands on which certain hydroelectric generating facilities belonging to the Manic–Outardes complex are located. This community is claiming $500 million. Hydro-Québec is challenging the legitimacy of this claim. In 2015, the Superior Court granted a motion in which the Innus of Pessamit requested that proceedings be stayed. In November 2017, the parties agreed on a new schedule for the recommencement of proceedings, under which the Innus of Pessamit have until June 2019 to complete the expert assessments they intend to file. A case management conference will then be convened.

Note 12 Segmented Information

The following tables present information on segment results and assets:

							Three months ended June 30, 2018
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	391	40	2,566[a]	–	294[b]	–	**3,291**
Intersegment customers	1,008	844	20	517	463	(2,852)	**–**
Net income (loss)	282	168	(112)	–	285	–	**623**

a) Including an amount of $(12) million for variance accounts related to weather conditions.
b) Including a $277-million gain on the partial sale of a subsidiary.

							Three months ended June 30, 2017
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	390	26	2,480	–	12	–	2,908
Intersegment customers	1,000	818	20	622	430	(2,890)	–
Net income (loss)	316	169	(131)	–	5	–	359

Note 12 Segmented Information (continued)

							Six months ended June 30, 2018
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	945	73	6,477[a]	–	303[b]	–	**7,798**
Intersegment customers	2,591	1,694	41	858	897	(6,081)	**–**
Net income	1,186	345	475	–	261	–	**2,267**
Total assets as at June 30, 2018	32,978	22,941	13,543	42	8,432	(214)	**77,722**

a) Including an amount of $36 million for variance accounts related to weather conditions.
b) Including a $277-million gain on the partial sale of a subsidiary.

							Six months ended June 30, 2017
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	948	39	6,156	–	22	–	7,165
Intersegment customers	2,499	1,651	41	1,000	843	(6,034)	–
Net income (loss)	1,158	355	390	–	(1)	–	1,902
Total assets as at June 30, 2017	32,984	21,940	13,326	54	5,936	(190)	74,050

Note 13 Comparative Information

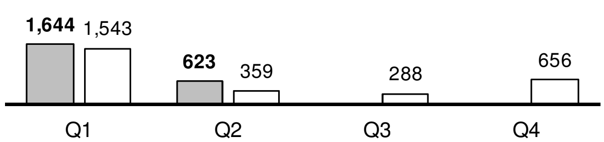
Some corresponding period data of the prior year have been reclassified to conform to the presentation adopted in the current period.

CONSOLIDATED FINANCIAL HIGHLIGHTS
(UNAUDITED)

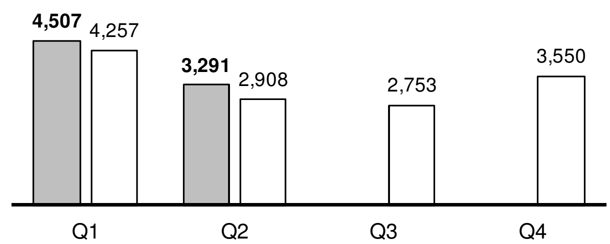
Amounts shown in tables are in millions of Canadian dollars.

	Three months ended June 30				Six months ended June 30			
Summary of Results	**2018**	2017	Change (%)		**2018**	2017	Change (%)	
Revenue	**3,291**	2,908	13.2	↑	**7,798**	7,165	8.8	↑
Expenditure	**2,014**	1,934	4.1	↑	**4,219**	4,031	4.7	↑
Financial expenses	**654**	615	6.3	↑	**1,312**	1,232	6.5	↑
Net income	**623**	359	73.5	↑	**2,267**	1,902	19.2	↑

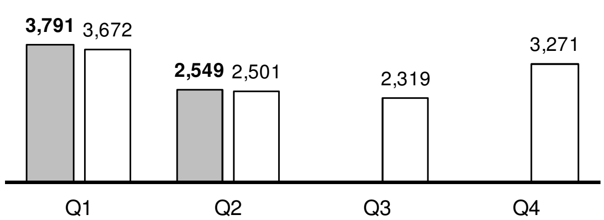
Net Income



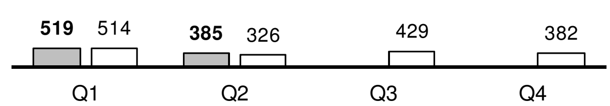
Revenue



Revenue from Electricity Sales in Québec



Revenue from Electricity Sales Outside Québec



2018 2017

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