

CONTINUED STRONG EARNINGS IN ELECTRICITY SECTOR DESPITE ECONOMIC DOWNTURN

Continued consolidation and continued major investment programmes. Power companies have been relatively unaffected by the financial crisis, and most have reported strong year-end results for 2008. Cash, liquidity and financing were key issues during the second half of the year.

Thousands of companies operate in the various national and regional energy markets in Europe – everything from local, municipal companies to very large international companies with operations spanning the entire value chain: generation, distribution, electricity trading and sales to end customers. Several companies also have substantial sales of gas and are actively striving to integrate their electricity and gas operations.

Ever since the local energy markets began opening up to competition in the 1990s, a sweeping structural transformation has taken place across national borders. Since electricity companies lacked opportunities to export, they instead focused on acquiring market shares in other countries. Europe's electric utilities are striving to achieve economies of scale, spread their risk and establish a pan-European presence. The trend has moved toward fewer, but larger, international players. For example, France's EDF has grown through major acquisitions in the UK, Germany, Italy and eastern Europe. Germany's E.ON has acquired companies in the Nordic countries, Spain, Italy, eastern Europe and Russia, among other markets. Two "mega-deals" were initi-

ated in 2005 and 2006: In Spain, Gas Natural made a bid for Endesa, which was followed by a competing bid from E.ON, and a merger between the French companies Suez and Gaz de France (GDF) was announced. Both deals proved to be very difficult to carry out, and it was not until some time into 2008 that any outcome could be seen. Neither Gas Natural nor E.ON succeeded in taking over Endesa. Instead, Endesa was jointly acquired by the Italian company Enel and Spain's Acciona, while E.ON acquired power assets in Endesa and Enel worth nearly EUR 12 billion.

The merger between GDF and Suez, which includes the Belgian company Electrabel, was completed in July 2008. The new, combined GDF Suez is now one of the three largest electricity and gas companies in Europe.

In the Netherlands, plans to merge Essent and Nuon failed and both companies began seeking other development options. In January 2009 Germany's RWE announced that it had reached an agreement to acquire Essent, and in February 2009 Vattenfall announced that it has made an offer for Nuon. Back in 2007, Spain's Iberdrola acquired Scottish Power in the UK and the US company Energy East. In July 2008 Spain's Gas Natural announced that it had reached an agreement to buy ACM's controlling stake in Spain's integrated electricity company Union Fenosa. The motive for the deal was to achieve convergence and take advantage of synergies between electricity and gas. In September 2008 EDF announced that it had acquired British Energy, the owner and operator of Britain's nuclear power plants.

Two groups of power companies

After these deals, six major international players have emerged in Europe: EDF, Enel, E.ON, GDF Suez, Iberdrola and RWE. Several of these also have substantial operations outside Europe, mainly in North and South America. The opportunities for these companies to continue growing through acquisitions in Europe are limited due to a lack of potential acquisition candidates. However, they are expected to make complementary acquisitions – in Russia and eastern Europe, for example. In addition, a number of asset swaps will most likely be initiated as a result of the EU's demands for asset divestments to promote competition in the market.

The second group of European power companies consists of more regionally based companies: Centrica, CEZ, Dong,

Major acquisitions in last two years

Acquiring company	Acquisition target	Currency, amount (billions)
EDF, France	British Energy, UK	12.5 GBP
EDP, Portugal	Horizon Wind Energy, USA	2.9 USD
E.ON Germany	Parts of Endesa's and Enel's assets	11.9 EUR
E.ON Germany	OGK, Russia	3.3 EUR
E.ON Germany	Outstanding 44.6% in E.ON Sweden from Statkraft	Asset swap
Enel (Italy) and Acciona (Spain), jointly	Endesa, Spain	43.4 ¹ EUR
Enel, Italy	OGK5, Russia	2.6 EUR
Fortum, Finland	TGK10, Russia	2.7 EUR
Gas Natural, Spain	Union Fenosa, Spain	26.1 EUR
Gaz de France and Suez, France	Fusion	–
Iberdrola, Spain	Scottish Power, UK	11.6 GBP
Iberdrola, Spain	Energy East, USA	6.4 EUR
National Grid, UK	KeySpan, USA	6.2 EUR
Scottish & Southern Energy	Airtricity, Ireland	1.5 EUR

1) Enterprise value.

EnBW, Energias de Portugal (EDP), Essent, Fortum, Gas Natural, Nuon, Scottish & Southern Energy, Statkraft and Verbund. Some of these companies are generally regarded as acquisition candidates, while others are actively striving to grow through mergers or acquisitions. Germany's municipal-owned Stadtwerke companies are frequently singled out as acquisition targets. There are more than 700 such Stadtwerke companies in Germany – a few of which are of a substantial size and with operations in several different business segments.

Vattenfall today is positioned between these two groups – it is smaller than the companies in the first group with pan-European operations, but has considerably broader market positions than regional companies such as Fortum and Nuon. In addition, Vattenfall has explicitly stated its strategy to double its market share in Europe, from 5% today to 10% by 2030.

A relatively new trend is the ambition by oil and gas companies to integrate electricity activities. Dong, BP and Total are examples of such companies. Conversely, certain electricity companies are seeking to acquire positions in gas production by acquiring stakes in gas fields. Due to the crisis in the financial markets, opportunities to carry out continued acquisitions will be more difficult. On the other hand, falling prices may enable financially strong players to acquire assets at bargain prices.

Major investment programmes

In 2007 most energy companies in Western Europe shifted their focus from acquisitions to organic growth and launched extensive investment programmes, ranging from construction of entirely new power plants to upgrading and renewal of existing plants, to expansion and strengthening of their electricity networks. According to the Credit Outlook 2009 report, published by Société Générale in November 2008, the following investment programmes have been announced by some of the larger companies:

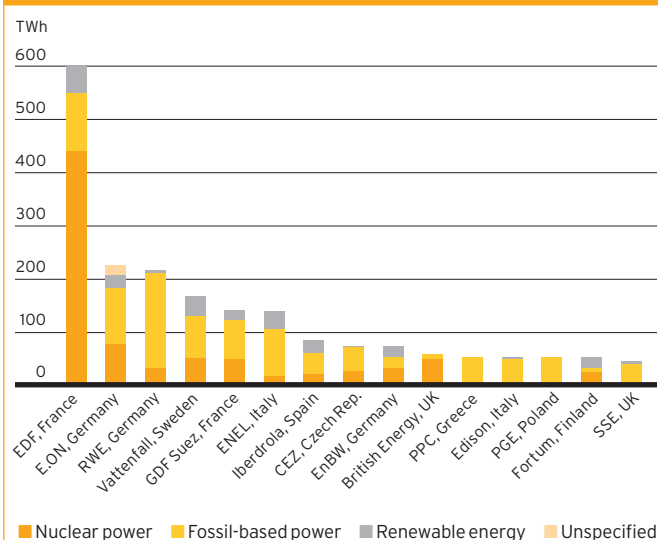
Company	Amount, EUR billion	Year
E.ON	60	2007–2010
EDF	30	2008–2010
GDF Suez	30	2008–2010
Enel	37	2008–2012
RWE	25	2007–2011
Iberdrola	18	2008–2010
Vattenfall	18	2008–2012 ¹

1) For the period 2009–2013, the investment programme amounts to SEK 191 billion.

Due to the financial crisis and economic downturn, a few companies have indicated that they will be reducing or delaying some investments if the negative market conditions persist. Investments in renewable energy – mainly wind power – have increased dramatically. Several companies have set ambitious targets for reducing their CO₂ emissions.

A number of companies have concentrated their investments in renewable energy in separate subsidiaries or business areas, such as E.ON Renewables, Iberdrola Renewables and RWE Innogy. In a few cases, such subsidiaries have become listed on the stock market. Effective 1 January

Europe's largest electricity generators, 2007



Taking into account Enel's acquisition of Endesa, Vattenfall is the fifth largest electricity generator. This is not reflected in the diagram above, since Enel did not consolidate Enesa until October 2007.

2009, Vattenfall has gathered its wind power assets in the new Wind Power business unit of the newly formed Business Group Pan-European.

Investments in nuclear power are also expected to increase. New nuclear power plants are currently being built in Finland and France, and in the UK the British government is encouraging companies to build new nuclear power plants. The bulk of investment is still being made in fossil-based energy (coal and gas). With the new Carbon Capture and Storage (CCS) technology, electricity can be generated from coal and gas plants with virtually no CO₂ emissions, and several companies are planning major investments in this area. Vattenfall has taken a leading role in this area and in September inaugurated the world's first CCS pilot plant based on so-called oxyfuel technology.

Strong operating profits in 2008 but substantially higher focus on liquidity issues

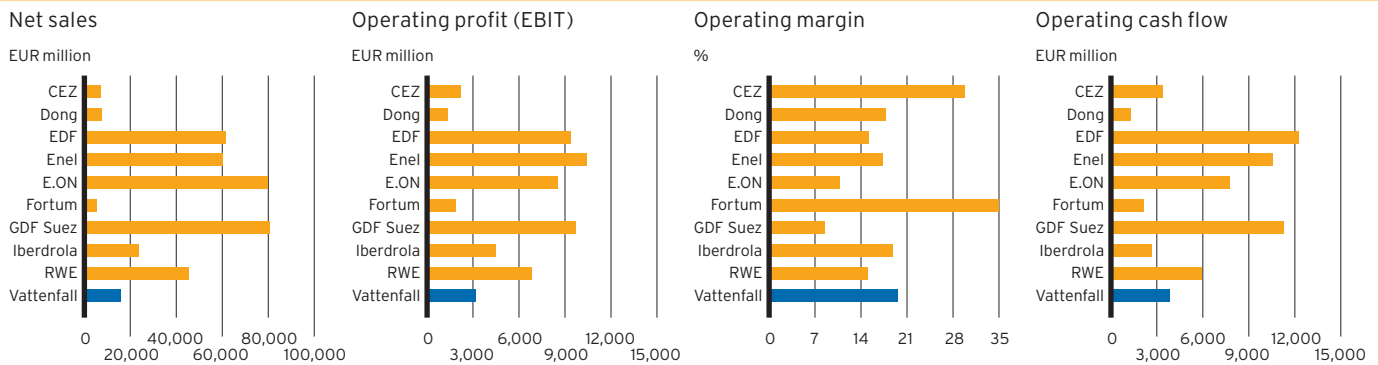
Owing to high electricity prices caused by rising prices for commodities and emission allowances during the first half of the year, most companies in the electricity sector managed to post continued strong financial results in 2008. By year-end the strong economic decline during the second half of 2008 had not yet had any negative impact on sales or cash flow. However, the financial crisis has generally led to financing problems and considerably higher borrowing costs. Companies as well as investors have therefore increased their focus on liquidity issues. As a result of recent years' acquisitions, increased investment programmes and large loan redemptions in 2009, companies in the electricity sector have very large borrowing needs. Therefore, at the end of 2008 many companies chose – when the opportunity arose – to issue bonds in order to prefund and strengthen their cash positions, even

though interest expenses had risen considerably compared with the first half of the year. This sharper focus on liquidity issues marked a clear break in trend compared with the situation in recent years, when companies consciously opted to increase their debt and lower their credit rating targets. Now companies are once again communicating their ambitions to defend a high credit rating in the “single A” category. Only

a few companies have lower rating targets or no rating commitments whatsoever.

Commodity and electricity prices generally have a large impact on earnings, although this impact can vary widely, depending on the company’s specific situation. A company’s product mix also affects its earnings. Companies with fixed-cost generation, such as nuclear or hydro power, are not

Comparison of selected European energy utilities (Data as per 30 September 2008, unless indicated otherwise)



	CEZ	Dong	EDF	Enel	E.ON
Country	Czech Republic	Denmark	France	Italy	Germany
Listing info	Listed (66%-owned by Czech state)	Unlisted (73%-owned by Danish state)	Listed in 2005 (approx. 85%-owned by French state)	Listed (31.2%-owned by Italian state)	Listed (Free float: 91%)
Electricity sales 2007, TWh	81	20 (generation)	652	196 (of which, Europe 189)	471 (of which, Europe 435)
Number of customers, millions	Electricity: 6.8	Electricity: 1.1 Gas: 0.1	Electricity: 41 (of which, Europe 38). Gas: 2.2	Electricity: 49 Gas: 3.3	Electricity: 25 (of which, Europe 24) Gas: 8
Primary products	Electricity, heat	Gas, oil, electricity	Electricity, gas	Electricity, gas	Electricity, gas
Primary markets	Czech Republic, Bulgaria, Romania, Poland	Denmark, (Sweden, Germany, Netherlands)	France, UK, Germany, Italy, Central and Eastern Europe (Asia, USA and Africa)	Italy, Spain, France, Russia, Portugal, Central and Eastern Europe, North and South America	Germany, Central and Eastern Europe, UK, Benelux, Nordic countries, Italy, Spain, Russia, USA
Strategies	<ul style="list-style-type: none"> To become a leading energy company in Central and South-eastern Europe Take advantage of synergies through vertical integration of activities Upgrade existing generation assets and build new plants Reduce CO₂ and NO_x emissions 	<ul style="list-style-type: none"> Integrate and consolidate newly acquired units Secure gas supply Expand electricity operations Integrate gas and electricity International growth (Sweden, Germany, Netherlands) 	<ul style="list-style-type: none"> Strengthen position in Western and Central Europe Take advantage of global nuclear revival Invest in gas in order to be able to offer customers both electricity and gas 	<ul style="list-style-type: none"> Create value in newly acquired companies (Endesa, companies in Russia) Seek out targeted growth opportunities in existing geographic markets and operating areas More focus on South America Continued growth in renewables and nuclear generation 	<ul style="list-style-type: none"> Strengthen position in Europe Strengthen gas supply position through own gas production and LNG Integrate assets in Spain, Italy and France USA a long-term growth opportunity

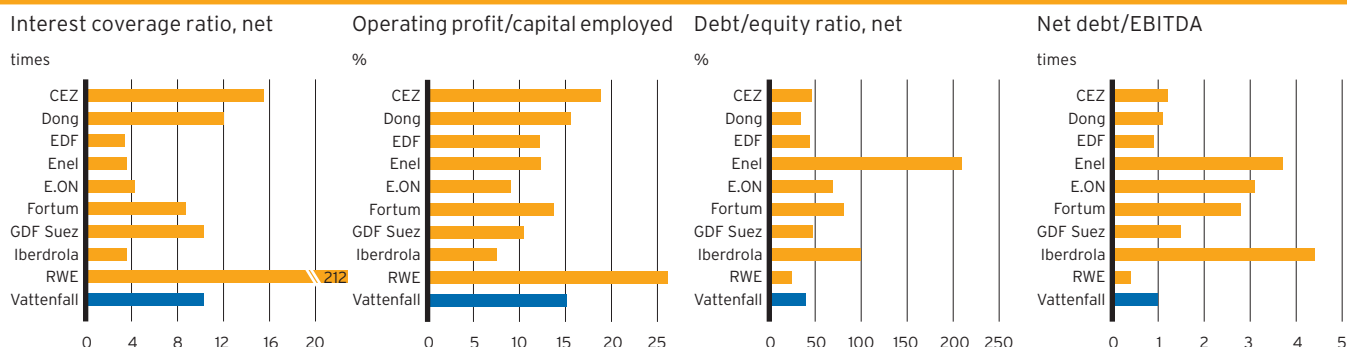
Exchange rates: EUR 1/SEK 9.76 (Vattenfall), EUR 1/CZK 24.78 (CEZ), EUR 1/DKK 7.46 (Dong).

Sources:

Graph values: Barclay’s Capital. Last 12-month values as per 30 September 2008 for all companies except EDF and GDF Suez, which are reported as per 30 June 2008. Electricity sales, number of customers, main products, main markets, strategies: Vattenfall research, various analyst reports, and the companies’ annual reports, interim reports and websites.

affected by rising fuel prices and therefore achieve higher margins. This applies, for example, for EDF and the Nordic power companies. Nor do higher commodity prices affect companies that own fuel assets, such as companies with own coal mines, like RWE, Endesa and Vattenfall. On the other hand, power companies with high CO₂ emissions are affected by higher costs for emission allowances.

Following is a comparison of the major European utilities with respect to size, operations, strategies and a number of key ratios. The presentation is not exhaustive, nor are the various companies ranked in any way. Compared with the corresponding comparison in Vattenfall's 2007 Annual Report, the companies have generally shown stable development.



Fortum	GDF Suez	Iberdrola	RWE	Vattenfall
Finland	France	Spain	Germany	Sweden
Listed (50.8%-owned by Finnish state)	Listed (French state owns 35.7%. Free float: 59%)	Listed (Free float: 84%)	Listed (Free float: 78%)	Unlisted 100%-owned by Swedish state
60	314 (of which, Europe 168)	159 (of which, Europe 130)	306	189 (206 incl. deliveries to minority owners)
Electricity: 1.6	Electricity: 5 (Europe) Gas: 17 (Europe)	Electricity: 23 (of which, Europe 14) Gas: 3 (of which, Europe 2)	Electricity: 14 Gas: 6	Electricity: 4.8 5.6 network customers
Electricity, heat	Electricity, gas, LNG, Energy services	Electricity, gas, engineering and construction	Electricity, gas	Electricity, heat, gas (starting in 2009)
Nordic countries, Baltic countries, Russia, Poland	France, Benelux, Germany, Italy, Spain, Portugal, Central and Eastern Europe, North and South America. Gas business worldwide	Spain, Portugal, UK, South America, USA	Germany, UK, Benelux, Central and Eastern Europe	Nordic countries, Germany, Poland, UK, Benelux (starting in 2009)
<ul style="list-style-type: none"> Be a leading power and heat company in the Nordic region through profitable growth Proceed with integration of Russian TGC-10 Expand in Nordic countries, Baltic countries, Poland and Russia 	<ul style="list-style-type: none"> Consolidate leadership positions and leverage complementary aspects between GDF and Suez Growth in upstream gas Growth in upstream electricity with special emphasis on nuclear and renewables 	<ul style="list-style-type: none"> Maintain world-leading position in renewable energy Growth in North and South America Repowering and environmental investments in traditional generation Divest non-core businesses 	<ul style="list-style-type: none"> Grow current business in gas and electricity, with focus on Germany and the UK Assess privatisation opportunities within the EU as well as in Russia and south-eastern Europe, incl. Turkey Expand the renewable energy business. Substantially reduce CO₂ emissions Expansion in midstream gas and strengthen upstream gas position 	<ul style="list-style-type: none"> Making electricity clean –Vattenfall's operations shall be climate-neutral by 2050 Five strategic ambitions: <ul style="list-style-type: none"> Number One for the Customer Number One for the Environment Profitable Growth Benchmark for the Industry Employer of Choice

Definitions:

Capital employed = Interest-bearing liabilities + equity including minority interests. Operating cash flow = FFO +/- change in working capital.

Net debt/EBITDA pertains to reported net debt.

Free float = The proportion of a company's shares that are freely available for trading.