

ECONOMIC PERFORMANCE

Management approach

Securing the future through economic value creation

Vattenfall strives to be a Benchmark for the Industry, with focus on operational efficiency and value creation. Expanding with good profitability is a prerequisite for contributing to sustainable development of society.

Measuring and managing performance

For a capital-intensive company like Vattenfall, it is important to generate a satisfactory capital return. Long-term value creation can be measured by operating profit less the required return on net assets to meet shareholder's return requirement. The overall long-term financial requirement for Vattenfall from its owner is a 15% return on equity (ROE) after tax. This is translated to a Group-wide return target that is expressed as a return on net assets before tax and financial costs (operating profit as a percentage of average net assets). The return target is currently 11% and is based on a balanced consideration of the financial targets. This target, in turn, is broken down into individually defined targets for each business unit, according to which operations are managed. The main reason for this reformulation to individual targets for each business unit is that Vattenfall's operations have widely varying conditions – mainly different asset bases in terms of size and age. Moreover, the company's equity and net financial income and expense are not distributed over the business units. The basic principle for this target formulation is that asset-intensive operations are assessed according to their return on the asset base, while service operations are assessed according to their operating margin.

Financial targets

Vattenfall's vision to be a leading European energy company is conditional upon economic value creation and profitable growth. These are the starting points for the Group's financial targets, which in turn are the platform for the business planning process at the business unit level. The financial targets are long-term, which means that they are to be evaluated as averages over a business cycle (approximately 5–7 years).

Main goal is long-term sustainable economic value creation

Creating economic value by generating a competitive return over time is Vattenfall's overriding financial objective, since the Group's other strategies are based on a requisite level of financial strength. The owner's required rate of return is used as the basis for setting targets for profitability, dividends and financial risk. The Board reviews the proposed targets and decides to propose them to the Annual General Meeting, where the owner then makes the final decision. Vattenfall's four current financial targets are:

- **Profitability.** The owner's long-term return target is that profit after tax will amount to 15% return on average equity. Translated to the Group's long-term required level of profitability, expressed as the return on net assets, this corresponds to a return of approximately 11% before tax and financial costs.
- **Dividend policy.** The aim is that the dividend over the long-term shall amount to 40%–60% of profit after tax. However, the yearly decisions on the dividend shall take implementation of the company's strategy, financial position and other economic targets into account.
- **Ratings.** It is Vattenfall's intention to maintain a long-term credit rating in the single A category from both Moody's and Standard & Poor's.
- **Cash flow interest coverage.** The cash flow interest coverage ratio after maintenance investments should amount to 3.5–4.5 times over the long-term. For a complete definition, see the 2008 Annual Report.

Vattenfall's investments

In 2008 Vattenfall invested a total of SEK 42.3 billion in energy generation, distribution and acquisitions.

Investments 2008

SEK Billion	
Hydro power	1.26
Wind power	2.57
Biomass, waste and peat	1.92
Nuclear power	3.58
Fossil-based electricity and heat	10.2
Electricity distribution	6.31
Acquisitions (shares and other)	16.4
Total	42.3

Five-year investment programme

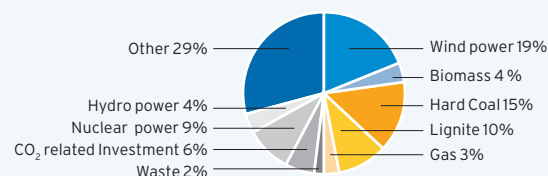
Investment planning is done long-term, and at the Vattenfall Group level, five-year investment plans are established. Investments are made in current operations and technologies that are viable and competitive for large-scale energy generation. In addition, Vattenfall conducts research and development activities within potential new energy sources and technology improvements (see EU7).

Vattenfall's growth target together with the target of reducing CO₂ emissions with 50% by 2030 and the climate vision to become climate-neutral by 2050, creates significant investment needs.

Five-year investment programme 2009–2013

SEK billion	
Wind power	37.2
Biomass	6.7
Hard Coal	27.7
Lignite	19.8
Gas	5.9
Waste	3.3
CO ₂ related Investments	11.4
Nuclear power	16.9
Hydro power	7.1
Other including distribution	55.0
Total	191.0

Five-year investment programme



Research and development activities (EU7)

Vattenfall's research and development (R&D) is distinctively directed towards supporting the Group's strategic ambitions and contributing to reductions in CO₂ emissions and an increased share of renewable fuels in the generation mix. The company's R&D focuses on improving energy efficiency in all segments of the value chain for energy supply – from fuel extraction, generation, and transmission to end uses of electricity and heat, including fuels for transportation. In addition, R&D work aims to prepare the company to meet new requirements, to address new business opportunities and to devise future energy solutions and thereby guide the company in its long-term strategies. R&D is also an important link between Vattenfall at present and the company's strategic ambition of Continued Profitable Growth, both through acquisitions and organic growth.

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The joint-Group R&D operations are aimed at long-term and visionary disciplines and topics of shared importance within the Group. Progress in technological development is introduced on a larger scale in operations when permitted by the commercial conditions. The two most important strategies for Vattenfall's long-term R&D and demonstration activities are climate change abatement and the role of the energy sector in the conversion to a long-term sustainable society.

Vattenfall is not a research and development company in the traditional sense, since does not develop equipment, but sets requirements and finds intelligent uses of equipment in energy systems. In some cases and under special conditions, Vattenfall co-operates with equipment suppliers in joint development projects.

To support Vattenfall's strategic ambitions and to help the Group achieve its long-term goals, R&D activities are performed in joint-Group R&D programmes. In 2008, R&D expenditures amounted to SEK 1,700 million, broken down among the various programmes as follows: renewables (10%), operational efficiency (8%), nuclear power (30%), energy efficiency (7%), Carbon Capture and Storage (43%) and new technologies (2%).

Provisions for decommissioning of nuclear power sites (EU8)

Vattenfall's nuclear power operations in Sweden and Germany have a legal obligation upon the cessation of production to decommission and dismantle the nuclear power plants and to restore the plots of land where the plants were located. Further, this obligation also encompasses the safeguarding and final storage of spent radioactive fuel and other radioactive materials used by the plants. The provisions include future expenses for the management of low- and medium-level radioactive waste.

For the Swedish operations, current estimations are that all of the provisions will result in disbursements after 2018. Current plans for the decommissioning of the German nuclear power operations entail about 94% of the provisions resulting in cash flows after 2010. For 2009 and 2010, respectively, disbursements are estimated at about 3% of the provisions per year.

Provisions for future expenses of nuclear operations

Changes in 2008, SEK million	Sweden	Germany	Total
Balance brought forward	21,869	7,944	29,813
Provisions for the period	47	-	47
Discounting effects	1,068	437	1,505
Revaluation (within the balance sheet)	5,496	2,494	7,990
Provisions used	-783	-241	-1,024
Provisions reversed	-	-129	-129
Translation differences	-	1,576	1,576
Balance carried forward	27,697¹	12,081²	39,778

1) Of which approximately 22% pertains to the dismantling, etc. of nuclear power plants and approximately 78% to the handling of spent radioactive fuel.

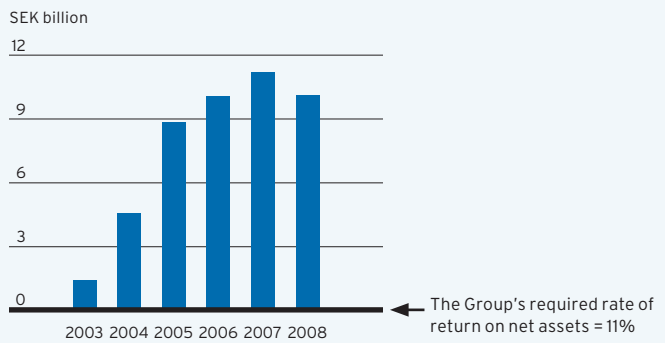
2) Of which approximately 58% pertains to the dismantling, etc. of nuclear power plants and approximately 42% to the handling of spent radioactive fuel.

Performance indicators

Economic value generated and distributed (EC1)

Economic value generated

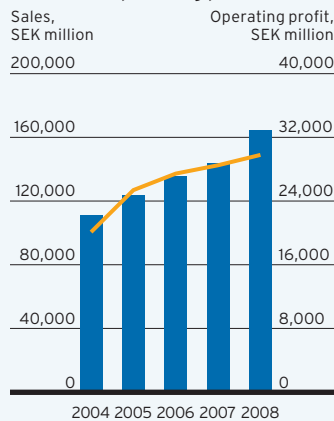
Value creation



The difference between achieved EBIT and the Group's required rate of return (expressed as 11% return on net assets) = an economic value that is generated by the operations every year, before tax.

Figures for 2004 and onward are calculated according to IFRS.

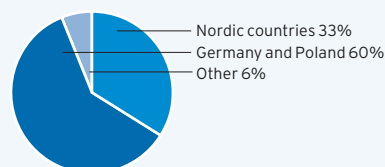
Sales and operating profit



■ Sales
— Operating profit¹

1) Excl. items affecting comparability.

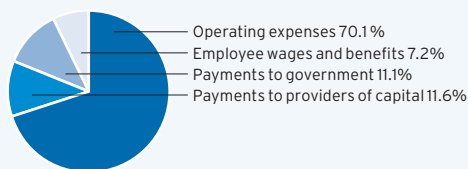
External net sales 2008 – breakdown geographically



Net sales as stated in the Annual Report for 2008, Note 6 to the consolidated accounts. See also Note 7 for a definition of segments.

Economic value distributed

Overview of economic value distributed 2008



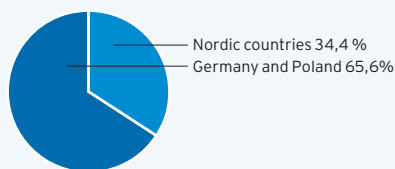
Note on operating expenses: The cost of all goods, materials and services is based on the information in Note 6 to the 2008 Annual Report and calculated as follows:

External net sales minus depreciation/amortisation/impairment losses/reversed impairment losses and operating profit, less employee wages and benefits and excise taxes.

Voluntary contributions and investment of funds in the broader community (includes donations) are not included in the above graph, see 4.16–17

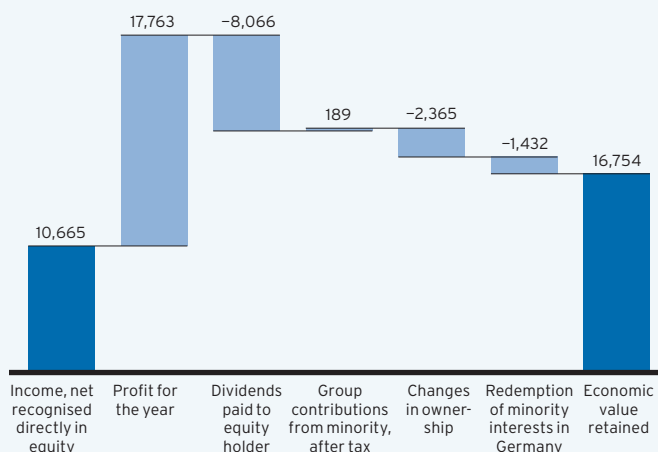
Payment to government 2008

Total taxes SEK 10,209 million.



Economic value retained 2008

SEK million



Financial implications due to climate change (EC2)

Major environmental issues representing financial risk/adverse financial impact

Vattenfall's business environment contains several uncertain factors that are related to climate change. Risks and opportunities are considered and managed throughout the organisation.

Examples of physical risks include changes in weather patterns, water shortages and warmer water temperatures that could affect cooling of combustion plants, more frequent and intensive storms that could have an impact on transmission and distribution networks, and hydro power dam safety, which could be affected by higher precipitation levels. An example of a regulatory risk that affects business is the post-Kyoto EU emission trading scheme, which will affect long-term investments.

Major environmental issues that represent an economical/financial opportunity

Focus on climate change will likely lead to higher demand for sustainable, efficient energy systems. The ability to provide heat and electricity with inherent efficiency and the potential for clean and sustainable generation technology could prove to be a tangible competitive advantage. Vattenfall is investing heavily in renewable energy generation and views renewable energy as a significant business opportunity.

Commercial success for Carbon Capture Storage (CCS) technology would contribute to a renaissance for lignite-fired power plants. As Vattenfall is taking the lead in CCS technology in the utility sector and has its own lignite mines, this may prove to be not only good business, but also a way to profitably bridge towards future energy solutions. Additionally, providing customers with tools to decrease their energy consumption is a small business today, but Vattenfall is investigating possibilities for expansion.

Coverage of benefit plan obligations (EC3)

Defined contribution pension plans

Defined contribution pension plans are post-employment benefit plans according to which fixed fees are paid to a separate legal entity. There is no legal or constructive obligation to pay additional fees if the legal entity does not have sufficient assets to pay all benefits to the employees. Fees for defined contribution pension plans are reported as an expense in the income statement in the period they apply to.

Defined benefit pension plans

Defined benefit pension plans consist of other post-employment benefit plans than defined contribution pension plans. The Group's defined benefit pension obligations are calculated separately for each plan in accordance with the Projected Unit Credit Method by calculating employees' current and past service cost. Estimated future salary adjustments are taken into consideration. The net obligation comprises the discounted present value of the total earned and estimated future salaries less the fair value of any plan assets. The discount rate consists of the interest rate on the balance sheet date of a first-class corporate bond with a lifetime that corresponds to the Group's pension obligations. When there is no deep market in corporate bonds of this kind, the market rate yield on government bonds with an equivalent lifetime is used instead.

When benefits in a plan are improved, the proportion of the increased benefit attributable to the employees' past service cost is reported as an expense in the income statement on a straight-line basis distributed over the average period until the benefits are wholly earned. If the benefits are fully earned, an expense is reported directly in the income statement.

For actuarial gains and losses, the so-called corridor rule is applied. Actuarial gains and losses arise from the effects of changes in actuarial assumptions. The corridor rule entails that the part of the accumulated actuarial gains and losses that exceed 10% of the greater of the obligations' present value and the fair value of plan assets is reported in the income statement, starting in the year after that they arise, over the expected average remaining service period for the employees covered by the plan.

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When the calculation leads to an asset for the Group, the reported value of the asset is limited to the net of unreported actuarial losses and unreported past service costs and the present value of future repayments from the plan or reduced future payments to the plan.

Government financial assistance (EC4)

Government grants

Grants are reported at fair value when it can reasonably be assumed that the grant will be received and that the Group will meet the conditions of the grant. A grant tied to a non-current asset reduces the book value of the asset. A grant intended to cover expenses is reported in the income statement as Other operating income. Government grants received, balance brought forward, amount to SEK 4,586 million (4,294). Accumulated interest reported as an asset, totalling SEK 912 million (757), is included in cost of buildings.

Spending locally-based suppliers (EC6)

Vattenfall's policy is to support competition where possible. Vattenfall will always buy from the supplier that is the most competitive and that fulfils established requirements. Although Vattenfall is an important contributor to the business life in the regions where it operates, local suppliers will never be favoured just on basis of being local. Furthermore, sourcing will turn more global as more of the world's suppliers gain access to the European markets. Vattenfall's procurement function embraces this development.

However, local and regional suppliers are competitive and still receive a large share of Vattenfall's order volume (86% in Nordic countries, 98% in Germany and 99.8% in Poland)¹.

1) Since the 2007 CSR report, the definition of "order volume" for EC6 has been harmonised. It now strictly excludes purchases of electricity, electricity grid fees, taxes and charges as well as internal transactions between Vattenfall companies. In the Nordic countries, the figure for 2007 is 80% according to the new definition.

Local workforce and management (EC7)

In the countries where Vattenfall operates, local residents represent the recruiting base. In regions where Vattenfall is one of the biggest employers (e.g., Cottbus in Brandenburg, Germany), local residents are the base for employment. In metropolitan areas, there is a mixture of local residents and people from different regions.

Local workforce is the base of setting up new business for Vattenfall, so knowledge of local people is the backbone of operations. When growing through acquisition, Vattenfall takes over the employee responsibility of local residents/people already working at the plants.

Investments and services for public benefit (EC8)

Vattenfall creates and distributes what is perceived as a common good, hence it is hard to separate and distinguish investments by the degree of public benefit. Most investments made represent public benefit in one way or another. For additional information see 4.16–4.17, EN3–4, EN5–7, EN16–18 and EU7.