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Vattenfall AB

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*(**Editor's Note:** In the original version of this article published Feb. 22, 2008, some 2007 figures for Vattenfall were misstated in Tables 2, 3, and 4. A corrected version follows.)*

Major Rating Factors

Corporate Credit Rating
A-/Stable/A-2

Strengths:

- Strong, vertically integrated position in the north European electricity market
- Large and geographically diverse operations
- Modern, flexible, low-cost generation portfolio
- Prudent trading and hedging policies
- Relatively stable cash flow from regulated, monopoly distribution and heating operations

Weaknesses:

- Exposure to competitive and volatile markets, exacerbated by long generation position
- Increasing regulatory and political pressure
- Inherent operating risks of nuclear operations
- A significant capital expenditure program over the medium term

Rationale

The ratings on Sweden-based utility Vattenfall AB reflect its strong, vertically integrated position in the north European electricity market, competitive generation portfolio, significant monopoly utility operations, and strong cash flow generation.

Negative rating factors include Vattenfall's exposure to competition and price volatility in power generation, political risks related to nuclear and coal generation, and increasing regulatory pressure on monopoly network operations.

Standard & Poor's Ratings Services does not currently factor any extraordinary support from Vattenfall's 100% owner, the Kingdom of Sweden, into the ratings. Political and taxation pressures on the company have increased, although the Swedish government appears to have no plans for restructuring or major strategy changes.

Vattenfall plans to invest about Swedish krona (SEK) 173 billion in the period 2008-2012, mainly in new power generation capacity, reinforcement of its electricity network, and life-time extensions of generation assets in Germany and the Nordic countries. Moreover, the company has embarked on significant renewables investments, mainly in wind power.

Following the integration of its acquired German operations, and the Danish power generation assets acquired in 2006, we expect Vattenfall to continue its growth strategy. Growth is expected to come through acquisitions and organically--both in existing markets and in nearby geographical markets. The number of potential acquisition targets will likely be limited and highly contested, however, pushing up asset prices.

Vattenfall's financial performance remains strong, with funds from operations (FFO) to adjusted debt at about 37% in 2007 (treating SEK9.3 billion in hybrid capital notes as 50% debt and 50% equity). In the absence of major acquisitions, and in view of continued strong wholesale power price development, this ratio should remain at about 30% over the medium term.

Short-term credit factors

The short-term rating is 'A-2'. We expect Vattenfall to have adequate internal liquidity over the short term, reflecting strong operating cash flows protected by hedging arrangements, and significant access to alternative sources of liquidity. Although a significant proportion of Vattenfall's operations are in highly competitive and volatile markets, movements in sales prices and volumes are unlikely to have a material negative effect on the company's liquidity and financial performance over the short term.

The adequate liquidity position is supported by:

- Adjusted cash and short-term investments, on Dec. 31, 2007, of about SEK15.9 billion, compared with SEK15.2 billion of short-term debt;
- Strong free operating cash flow of about SEK13.4 billion in 2007;
- Access to unused committed credit facilities of SEK9.6 billion at Dec. 31, 2007;
- The company's good access to public debt markets;
- The absence of rating triggers or onerous covenants in Vattenfall's financing agreements; and
- The company's policy of maintaining the equivalent of 10% of group turnover in cash or committed credit lines, or the equivalent of the next 90 days' debt maturities--whichever is greater.

Outlook

The outlook is stable, reflecting the increasing regulatory and political pressure in Vattenfall's main markets, which tempers the prospect of continued improved credit quality from its current strong level. Such pressure has resulted in increased shareholder demands, stricter regulation, and an increased focus on environmental and energy policy objectives for the company. Further adverse political or regulatory actions cannot be ruled out.

The stable outlook also reflects our expectation that Vattenfall will continue its growth strategy, be acquisitive, and increase capital expenditures over the medium term. This could weaken the financial profile from its current, strong, level, although we do not expect the company to jeopardize its objective of maintaining a rating in the 'A' category. In the current environment, with increased political and regulatory uncertainty, upside ratings potential is limited.

Business Description

Vattenfall is focused on electricity and heating operations in the Nordic region, Germany, and Poland, with a strong presence in all three areas. It is Europe's fifth-largest electricity generator and the largest heat generator in terms of volume delivered. The company's vision of being a leading European energy company suggests that it could become acquisitive again. In 2006, Vattenfall established a significant presence in Denmark through the acquisition of key generation assets, and now controls more than 20% of Danish power-generation assets. Expansion is expected to focus on core activities, with a geographic focus on countries where it already has operations and neighboring countries in Western as well as Eastern Europe. In May 2006, the company presented a roadmap setting out investment ambitions of SEK40 billion to increase renewable generation capacity in Sweden by about 10 terawatt-hours (TWh) by 2016. Total planned capital expenditure on generation and network assets is about SEK173 billion through 2012.

In the medium term, we expect about 70% of Vattenfall's cash flows to come from electricity generation and supply, with the remainder from monopoly transmission and distribution activities, and the heating business.

Government Ownership

Vattenfall is a commercially operated, limited liability company and 100% state-owned through the Ministry of Enterprise, Energy and Communications. The current Swedish government is unlikely to change the policy of retaining state ownership of the company, although, as stated, we do not factor state support into the rating. The previous government exerted some political pressure on the company on issues such as environmental investment, investment strategy, and power prices. Further political pressure during periods of high power prices, to satisfy public opinion, cannot be ruled out. The dilution of state ownership is possible in the medium to long term, although the current government has ruled out an IPO. Privatization could increase the company's strategic freedom, reduce the risk of political involvement, and enhance financial flexibility by allowing equity financing.

Strategy

Vattenfall has outlined five strategic ambitions focused around strong, profitable performance; environmental friendliness; and customer and employee satisfaction. Vattenfall's vision is "to be a leading European energy company". As such, the company is looking to grow in size through acquisitions and greenfield investments and capacity additions. At the same time, the company needs to focus on maintenance, capacity replacements, and life-time extensions as generation assets are approaching their technical retirement age and network assets are subject to increasing public and regulatory investment expectations.

Although we expect Vattenfall to remain acquisitive, the ongoing consolidation in the European power industry has resulted in highly priced acquisition targets, which may temporarily slow down any major expansion. In terms of geographical markets, the U.K., Eastern Europe, and the Benelux appear to be prioritized in terms of future growth.

Regulation

Vattenfall is exposed to intense competition and full deregulation in the Nordic and German electricity markets. The regulatory and political pressure in these markets has increased in recent years, seen by significant cuts by the regulator of German distribution tariffs in 2006 and 2007 respectively. Following this, Vattenfall took a €110 million impairment charge for its German distribution networks in 2006 and an additional €50 million impairment charge in its German subsidiary WEMAG in 2007. The German regulator imposed an 18% reduction in transmission tariffs from July to December 2006. Transmission tariffs for 2007, however, increased by 26% compared with the previous year.

The Swedish government increased property tax on hydro power and installed nuclear power capacity as of January 2006, resulting in increased annual costs of more than SEK1.5 billion. A further tax raise was announced as from 2008, resulting in additional SEK1.0 billion in annual costs for Vattenfall.

Regulatory models vary between the countries in which Vattenfall operates, and each presents different challenges. The controversial ex-post regulatory model in Sweden calculates tariffs based on the simulated cost for an optimal service area network, adjusted for the quality of service provided. This approach suggests that utilities are generally overcharging by 15%-20%. Several network operators challenged adverse rulings from the regulator concerning

2003 distribution tariffs in court. Over the course of the court processes, however, the regulator has reduced its demand following recalculations of the weighted average cost of capital rate used in the tariff model. A new ex-ante regulatory model is expected to be implemented in Sweden by 2012.

In 2005, Germany introduced ex-ante regulation, and is moving to an incentive-based regulatory model, which implementation, however, seems to be postponed until 2009. During the transition period, further adverse measures cannot be ruled out. That said, the rating factors in gradual pressure on Vattenfall's German network tariffs as a result of evolving regulation.

The allocation of carbon dioxide (CO_2) allowances in the second phase to the German generation sector was smaller than expected. For Vattenfall's German operations--and its fossil-fuel intensive generation mix--this translates into a deficit of CO_2 certificates corresponding to 28-33 million tonnes. According to Vattenfall, the estimated annual effect on post-tax profit and on cash flow could amount to €400-€500 million as of 2008, assuming a CO_2 price of €20/tonne.

Vattenfall's Nordic and German district heating businesses benefit from their loosely regulated virtual monopoly status. We expect the noncyclical, albeit weather-dependent, heating operations to continue to support Vattenfall's business position, although the heating business could become more strictly regulated. On the other hand, Polish heat regulation is expected to become more transparent over time, on the back of economic growth and increased stability.

Nuclear operations remain exposed to inherent political risks, although political development in both Germany and Sweden could result in life-time extensions at existing facilities and potentially also new builds of nuclear generation capacity.

Markets

Vattenfall benefits from operating in the prosperous and stable markets of the Nordic countries and Germany, although this is balanced by a modest long-term volume growth (at about 0.5% per year) in these regions. Medium-term growth in the Polish electricity consumption is expected to be 1.8%-3.0% per year. Exposure to the riskier Polish heat market should remain limited. The company's geographic coverage provides some diversification benefits. Nevertheless, Vattenfall remains exposed to long positions in power generation in these competitive and slow-growing markets. The tightening of the supply and demand balance, and increasing power prices have mitigated this exposure. The company has about 5.0 million electricity supply customers, of which about 2.6 million are in Germany--largely in the Hamburg and Berlin urban areas. Following market deregulation and a higher retail churn--coupled with the nuclear outages at two of Vattenfall's German reactors--Vattenfall lost about 250, 000 customers in Germany in 2007.

European wholesale power prices increased in the second half of 2007--a trend continuing into January 2008--driven by increased fuel costs (mainly for coal) and a higher price on CO_2 following a cut down of emission allowances in the second phase. The European Energy Exchange base load spot prices averaged €50.8 and €38.7 per megawatt-hour (MWh) in 2006 and 2007, respectively. German wholesale prices will likely remain above €35 per MWh in the short to medium term, with development driven by the pricing of CO_2 emissions trading, fuel, and import volumes from France and Eastern Europe. Nordic power prices remain lower than the European prices, mainly due to good hydropower availability. The average system spot price on NordPool was €48.6 and €27.9 per MWh in 2006 and 2007, respectively.

We expect Nordic wholesale prices to normalize at about €25-€30 per MWh in the medium term, however, with significant volatility in light of the region's dependence on hydro generation. In the longer term, prices could harmonize with the higher Continental European price level following a gradual integration of the power systems.

Vattenfall has less downstream outreach in Germany than competitors such as E.ON AG and RWE AG--a situation that underpins Vattenfall's long generation position.

The stable and profitable electricity distribution business should provide a key strength for Vattenfall's business profile, because market risk is below average. Vattenfall has about 1.3 million Nordic customers, most of which are in rural areas. The 3.3 million German network customers are mainly located in urban areas, which is positive for the business profile. Vattenfall's transmission operations also have low market risk, despite serving the less prosperous eastern part of Germany. The Polish electricity distribution operations, with some 1.1 million customers, carry higher market risk, but are still too limited to materially affect Vattenfall's market risk.

Operations

Vattenfall's modern, flexible, low-cost generation portfolio underpins its ratings as well as its district heating operations, providing a source of stable cash flow. A high proportion of nuclear generation has mixed implications; while it supports Vattenfall's strategy to reduce CO2 emissions, it also carries a higher operating risk compared with other sources of generation. The outages at the company's Swedish and German nuclear power plants in 2006 and 2007 have resulted in increasing political and public demand to improve security measures. Other negatives include a CO2 intense generation mix in the German operations, and weather-related reliability problems in the Swedish distribution networks.

Generation.

Vattenfall's generation portfolio is fairly modern, competitive, and well diversified, both geographically and in terms of generation mix. It mainly comprises lignite plants in Germany, nuclear plants, and significant low-cost and low-risk Swedish hydro-generation assets. Vattenfall has also embarked into significant investments in renewable energy, with the construction of large wind farms in Sweden, in some cases in partnership with companies that own the land. According to the company's roadmap for investments in renewable energy, Vattenfall aims to install about 7 TWh-8 TWh of new wind capacity by 2016.

The vertical integration of lignite fuel supply in Germany reduces operational risks, and Vattenfall's control over this important cost item allows for increased margins when power prices are boosted by high fuel prices. The company has historically been able to manage mining-related environmental issues.

CO2 emissions, however, are inherently high in all coal-fired generation, and further emissions restrictions or penalties could constitute a future risk. Mitigating factors include the fact that domestic coal remains integral to the German government's long-term energy policy, and that Vattenfall's European lignite supply is not subsidized or affected by world coal-market prices. Vattenfall is actively managing CO2 emission reductions, and is building the first power plant based on the so-called carbon-capture-storage technology in Germany (due on line in the second half of 2008), at an estimated cost of about €70 million.

In both Sweden and Germany, Vattenfall is a highly experienced nuclear operator. Nevertheless, nuclear operations are subject to inherent safety and political risks. In 2006, a serious incident occurred at Vattenfall's Forsmark reactor in Sweden. The incident forced the facility to close for more than two months to enable safety investigations. In Germany, Vattenfall's nuclear reactors at Brunsbüttel and Krümmel suffered unplanned outages due to events at the power plants in 2007. The events, classified as "0" on the International Nuclear Event Scale, resulted in a significant loss of public trust for Vattenfall, and sparked a heated political debate in Germany over nuclear safety.

Trading.

Vattenfall's extensive in-house trading and portfolio-management operations are integrated into a single trading organization. Risk management practices appear adequate. Trading is asset based, with the focus on hedging Vattenfall's generation and supply activities to reduce exposure to price volatility and generate revenue certainty. This creates a time lag before price increases and reductions fully affect cash flows, which means that cash flows can be sustained, or even increased, despite falling spot market prices. Proprietary trading is limited.

Electricity transmission and distribution.

Electricity distribution is a key strength of the group, and it will likely be able to further enhance performance in this area by sharing best practices and exploiting economies of scale. The Nordic operations are generally efficient, but some quality problems (related to severe, recurring weather-related interruptions) have been revealed, and the company aims to invest more than SEK10 billion through 2010 in Nordic networks. The high-quality German network operations benefit from having a mainly urban customer base. Vattenfall controls close to 30% of the German transmission grid. Vattenfall's network area in the industrialized south of Poland is also densely populated, and this operation is reportedly fairly efficient.

Heating.

Vattenfall is a major district and industrial heating supplier in the Nordic region. Outside the region, operations will be dominated by heat supplies to the major urban areas of Warsaw, Berlin, and Hamburg. Most of this generation comes from coal-fired combined heat and power plants, but the required environmental upgrading has been performed. We expect Vattenfall to maintain stable and profitable heating operations.

Table 1

Vattenfall AB Operating Statistics

	2007	2006	2005	2004	2003	2002	2001
Total capacity (MW)	35.230	35.114	32,448	32,918	31,685	31,800	28,000
Generation (GWh)	167.6	165.4	169.1	167.1	155.8	158.5	140.9
Nuclear (%)	31	33	35	37	36	33	41
Oil and coal (%)	46	45	41	43	46	45	30
Hydro (%)	22	21	24	20	18	22	28
Purchases (GWh)	57,500	56,700	64 400	52,000	57,700	57,200	34,800
Electricity sold	193.800	191.100	200,300	186,400	184,200	188,300	149,900
Retail customers (000s)	5,729	5,687	5,794	5,040	4,860	4,600	2,100
Type of network (kV)	up to 440	up to 440	up to 440	up to 440	up to 440	up to 440	up to 440
District-heating deliveries (GWh)	36,200	35,200	34,100	34,500	35,600	30,600	22,800
Number of employees	32,396	32,308	32,231	33,017	35,300	34,200	23,800

GWh--Gigawatt-hours. kV--Kilovolts.

Competitive position/profitability

Vattenfall's competitive position is above average in both the Nordic and German markets, reflecting its low-cost generation, ability to exploit economies of scale in all areas of operations, and experience of a competitive market environment. Negative factors include the imbalance between generation and end-user sales, although this problem could reduce as the capacity balance tightens. Vattenfall can offer qualified energy-facility management and other energy-related services, which will likely be more important to the group's future competitive position in the large-user customer segments.

Vattenfall holds a No. 3 position in the German market within electricity generation after RWE and E.ON, respectively. In the Nordic area, Vattenfall is the largest electricity generator, with a 20% market share. Within distribution and sales in the Nordic area, Vattenfall ranks second and fourth, respectively.

Vattenfall's return on common equity was 18.5% and 21.4% in 2007 and 2006, respectively, which is in the higher end compared to peers (see table 1). On a divisional level, earnings performance is mainly driven by the generation and heat segment, benefiting from high electricity prices and a high share of CO2-free generation. Pressure on tariffs--particularly in Germany--has resulted in deteriorating profitability within Vattenfall's network operations, whereas gross margins in electricity retail sales remain under pressure due to fierce competition in Vattenfall's main markets.

Table 2

Vattenfall AB -- Peer Comparison*

	Vattenfall AB	Vattenfall AB	Fortum Oyj	E.ON Sverige AB	Statkraft SF
Corporate credit rating¶	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2	A/Stable/A-1	BBB+/Stable/A-2
(Mil. €)	Fiscal year ended Dec. 31, 2007	Fiscal year ended Dec. 31, 2006	Fiscal year ended Dec. 31, 2006	Fiscal year ended Dec. 31, 2006	Fiscal year ended Dec. 31, 2006
Revenues	15,200.0	15,050.1	4,491.0	2,913.9	1,840.1
Net income from cont. oper.	2,092.0	2,075.6	1,071.0	381.5	723.2
Funds from operations (FFO)	3,670.9	4,061.2	1,397.8	867.2	1,040.7
Capital expenditures	2,024.7	1,789.2	487.6	601.9	437.8
Cash and investments	1,683.0	1,717.4	157.0	30.0	214.1
Debt	10,003.8	10,821.3	5,129.9	2,931.5	4,123.3
Preferred stock	494.2	493.8	0.0	0.0	0.0
Equity	13,680.4	12,203.8	8,170.4	4,011.1	4,737.7
Debt and equity	23,684.3	23,025.1	13,300.3	6,942.6	8,861.0
Adjusted ratios					
EBIT interest coverage (x)	6.0	6.1	7.6	5.6	6.5
FFO interest cover (x)	7.5	8.1	7.3	8.8	5.7
FFO/debt (%)	36.7	37.5	27.2	29.6	25.2
Discretionary cash flow/debt (%)	6.3	14.1	(5.0)	(0.5)	(6.0)
Net cash flow/capex (%)	140.2	189.0	84.2	115.9	98.9
Debt/total capital (%)	42.2	47.0	38.6	42.2	46.5
Return on common equity (%)	18.5	21.4	14.2	10.6	16.0
Common dividend payout ratio (unadjusted) (%)	40.5	40.0	104.5	55.5	20.1

*Fully adjusted (including postretirement obligations). ¶Ratings as of Feb. 21, 2008. N.M.--Not meaningful.

Financial Risk Profile

Accounting

Vattenfall's consolidated accounts are prepared under International Financial Reporting Standards, adopted in 2005.

The key analytical adjustments made by Standard & Poor's relate to postretirement benefit obligations, asset retirement obligations (ARO), hybrid capital, and operating lease adjustments, as outlined below (see table 2).

- Unfunded postretirement obligations added about SEK17.1 billion to our broader measure of financial obligations at the end of 2007, with little tax effecting as most of the unfunded obligations were in Germany.
- A further SEK17.7 billion is added due to unfunded ARO for the German mining and consolidated nuclear operations, net of the Swedish nuclear ARO surplus of about SEK2.3 billion.
- Operating lease adjustments amount to about SEK3 billion.
- We reclassified from debt to equity 50% of the principal (SEK9.3 billion) in capital securities to which we attribute intermediate equity content.
- Vattenfall reported cash and short-term investments of SEK22.7 billion at Dec. 31, 2007. We adjust this figure for about SEK3.2 billion, which is earmarked for the German nuclear accident joint insurance agreement, and additional SEK3.5 billion is attributable to the minority owner's share of cash at Vattenfall's 66.7%-owned German Brunsbüttel nuclear plant.

Other significant adjustments relate to the estimated excess cash position in minority owned German nuclear affiliates. Vattenfall only consolidates one majority owned German plant. The nonconsolidated minority plants have set aside cash to cover future nuclear decommissioning liabilities. This cash is onlent to Vattenfall and appears on the company's balance sheet as loans from associated companies (SEK11.1 billion at Dec. 31, 2007). Vattenfall's actual decommissioning liability for these plants was SEK9.2 billion at the end of 2007. Adjusting for additional SEK3.6 billion of cash at the associate company level (Vattenfall's share), SEK5.6 billion--which is the amount by which the affiliates are over funded versus the estimated actual liability related to them--is consequently netted against Vattenfall's debt.

Table 3

Reconciliation Of Vattenfall AB Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. SEK)*

	--Fiscal year ended Dec. 31, 2007--							
Vattenfall AB reported amounts								
	Debt	**Shareholders' equity**	**Operating income (before D&A)**	**Operating income (before D&A)**	**Operating income (after D&A)**	**Interest expense**	**Cash flow from operations**	**Cash flow from operations**
Reported	67,189.0	111,709.0	45,069.0	45,069.0	28,583.0	3,325.0	32,331.0	32,331.0
Standard & Poor's adjustments								
Operating leases	2,914.9	--	550.5	145.7	145.7	145.7	404.8	404.8
Intermediate hybrids reported as debt	(4,670.5)	4,670.5	--	--	--	(248.6)	248.6	248.6
Postretirement benefit obligations	17,017.8	476.6	81.0	81.0	81.0	811.0	262.8	262.8

Table 3

Reconciliation Of Vattenfall AB Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. SEK)* (cont.)								
Capitalized interest	--	--	--	--	--	109.0	(109.0)	(109.0)
Asset retirement obligations	17,645.0	--	--	--	--	883.0	(176.0)	(176.0)
Reclassification of nonoperating income (expenses)	--	--	--	--	1,410.0	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	1,718.0
Minority interests	--	12,423.0	--	--	--	--	--	--
Other	(5,560.6)	--	(1,084.0)	(1,084.0)	--	--	--	--
Total adjustments	27,346.6	17,570.1	(452.5)	(857.3)	1,636.7	1,700.1	631.2	2,349.2

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations
Adjusted	94,535.6	129,279.1	44,616.5	44,211.7	30,219.7	5,025.1	32,962.2	34,680.2

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts. SEK--Swedish krona.

Corporate governance/risk tolerance/financial policies

Vattenfall has focused on improving its financial profile after several large acquisitions weakened the balance sheet and credit metrics. Further financial improvement in the medium to long term will be influenced by the group's attitude to further debt-financed expansion, and the Swedish government's dividend requirements. According to the financial targets, revised in 2006, dividends will amount to 40%-60% of net income. Other financial targets include cash-flow interest coverage after maintenance investments of 3.5x-4.5x and a 15% post-tax return on equity (ROE). Vattenfall has a stated commitment to maintaining a rating in the 'A' category.

At the parent company level, Vattenfall is not subject to structural subordination.

Cash-flow adequacy

Vattenfall's profitability and cash flow are underpinned by its monopoly electricity distribution and heating operations. The Nordic region and Germany accounts for the vast share of earnings (44% and 54% of 2007 EBIT, respectively). Due to the high share of nuclear and lignite-based generation, we consider the operations in Germany and Poland to be less volatile than the Nordic operations, bringing stability to Vattenfall's financial profile. Both profitability and cash-flow debt-protection measures have developed to become strong for the rating level, mainly owing to high wholesale prices, cost savings, and lower interest costs.

FFO interest coverage was 7.5x in 2007 (compared with 8.1x in 2006). FFO to debt was about 37% in 2007, largely unchanged compared with 2006. The company's strong liquidity underpins these key ratios. Maintenance of both ratios at, or more than, 4.5x and 20% is consistent with the 'A-' rating. We expect Vattenfall to maintain both ratios comfortably above these levels over the medium term, in the absence of larger debt-funded acquisitions. .

Vattenfall's increased capital-expenditure program targets total investment of SEK173 billion through 2012, of which the bulk will be used for life-time extensions in generation plants in Vattenfall's German operations.

Greenfield investments include mainly wind power in the Nordic region as well as in Germany.

The company should be able to fund investments from internal cash flows, although there is headroom at the current rating level for debt-funded investment.

The ultimate cash-flow effect on debt will depend on any acquisitions and the associated potential for debt consolidation, and the owner's dividend requirement.

Capital structure and financial flexibility

Vattenfall's reported total borrowings decreased by SEK4.4 billion to SEK67.2 billion in 2007, corresponding to an adjusted debt to capital of about 42% (compared with 47% in 2006). Some of Vattenfall's assets, in particular its Swedish hydro power stations, are carried in the balance sheet at low depreciated book values, and debt-leverage ratios would look substantially stronger if equity were adjusted for these hidden values.

Vattenfall's capital structure and liability management are adequate, in view of the following factors:

- Average time to maturity of 6.5 years (excluding Vattenfall's capital securities, and loans from associated companies and minority owners) at Dec. 31, 2007 (Vattenfall's target is a minimum of five years).
- At the end of December 2007, debt maturities were reasonable and well spread over the medium term, although with some concentration of debt maturing in 2009 and 2010, and there is some very long-dated debt.
- Interest exposure is adequate. The average interest duration Dec. 31, 2007 was 2.6 years, within the company's policy range of 1.5 years-3.5 years.
- Foreign-exchange exposure is limited. Vattenfall's interest-bearing debt is hedged in Swedish krona or euros. The German operations provide the company with a natural hedge in the Eurozone.
- Liquidity is adequate. Short-term debt at the Dec. 31, 2007 was SEK15.2 billion, compared with adjusted cash and liquid investments of about SEK16.7 billion. In addition, the company has access to unused committed credit facilities of SEK9.6 billion.
- The company maintains a policy of having an equivalent of 90 days' maturities in the form of liquid assets and unused committed facilities, and to continuously have cash reserves equaling 10% of turnover. The cyclicality of cash flows resulting from the seasonal demand pattern for electricity and heating is manageable.
- There are currently no significant contingent requirements. Vattenfall's debt and committed backup facilities do not include any rating triggers, onerous financial covenants, or material adverse change clauses.
- Funding diversity is adequate to strong. Vattenfall is a well-established borrower with strong bank relationships and access to a wide variety of funding alternatives, including a €6 billion European MTN program, a SEK10 billion domestic MTN program, bank loans, CP programs in the Swedish krona, and euro markets, and a €1.0 billion revolving credit facility (maturing 2013).

Vattenfall's financial flexibility is adequate, in view of the following:

- Shareholder pressure is average. On balance, we assess government ownership as neutral from a creditor perspective. Overall, it could allow for some more flexibility in dividend payout, but reduces the room for using equity funding for growth.
- The 2005 issue of about €1 billion of deeply subordinated capital notes, the equity content of which we assess as intermediate--implying, numerically, a 50% equity treatment by Standard & Poor's--provides some flexibility. (For more information, see "Corporate Ratings Criteria--Equity Credit: What It Is And How You Get It; Factoring Future Equity Into Ratings; Tax-Deductible Preferred And Other Hybrids; "A Hierarchy Of Hybrid

Securities," published on July 8, 2005, on RatingsDirect.)

- Capital-expenditure flexibility is adequate to weak. We note some flexibility in the capital-expenditure programs.
- Vattenfall's debt capacity is adequate to strong. At the end of December 2007, the company had unused headroom of about SEK63.6 billion under its various debt issuance programs--equivalent to about 1.1x of reported gross debt, and more than 4x the amount of reported short-term debt.
- Ownership support and regulatory relief are weak. No ownership support is factored into the ratings, owing to the historical absence of any equity infusions into the company, our view of Vattenfall as a commercial investment, and the absence of any supporting statements. The room for any financial regulation is restricted given the regulation applied in Vattenfall's core markets.

Table 4

Vattenfall AB -- Financial Summary*

	--Fiscal year ended Dec. 31--				
(Mil. SEK)	**2007**	**2006**	**2005**	**2004**	**2003**
Rating history	A-/Stable/A-2	A-/Stable/A-2	A-/Positive/A-2	A-/Stable/A-2	A-/Stable/A-2
Revenues	143,639.0	135,802.0	129,158.0	113,366.0	111,935.0
Net income from continuing operations	19,769.0	18,729.0	19,235.0	8,944.0	9,123.0
Funds from operations (FFO)	34,680.2	36,652.3	31,885.7	24,747.8	18,191.0
Capital expenditures	19,261.9	16,037.3	12,698.5	9,963.5	8,554.0
Cash and short-term investments	15,904.0	15,497.0	7,140.1	10,108.0	11,105.0
Debt	94,535.6	97,644.3	106,326.8	105,213.7	85,547.0
Preferred stock	4,670.5	4,455.5	4,634.0	0.0	0.0
Equity	129,279.1	110,118.5	92,709.8	82,466.5	61,885.0
Debt and equity	223,814.7	207,762.8	199,036.6	187,680.2	147,432.0
Adjusted ratios					
EBIT interest coverage (x)	6.0	6.1	6.4	4.4	3.7
FFO interest cover (x)	7.5	8.1	7.5	6.3	3.9
FFO/debt (%)	36.7	37.5	30.0	23.5	21.3
Discretionary cash flow/debt (%)	6.2	14.2	5.1	11.4	9.0
Net cash flow/capex (%)	139.3	190.3	204.6	222.3	190.0
Debt/debt and equity (%)	42.2	47.0	53.4	56.1	58.0
Return on common equity (%)	18.9	21.1	25.0	14.1	18.7
Common dividend payout ratio (un-adj.) (%)	40.5	40.0	30.2	62.6	26.3

*Fully adjusted (including postretirement obligations). SEK--Swedish krona.

Ratings Detail (As Of February 18, 2009)*

Vattenfall AB	
Corporate Credit Rating	A-/Stable/A-2
Commercial Paper	A-2
Nordic National Scale Rating	K-1
Senior Unsecured	A-
Subordinated	
Foreign Currency	BBB+

Ratings Detail (As Of February 18, 2009)*(cont.)	
Corporate Credit Ratings History	
06-Sep-2006	A-/Stable/A-2
21-Jun-2005	A-/Positive/A-2
04-Apr-2003	A-/Stable/A-2
Business Risk Profile	1 2 3 4 $\boxed{5}$ 6 7 8 9 10
Financial Risk Profile	Moderate
Debt Maturities	
At Dec. 31, 2007 (excluding loans from minority owners and associated companies of SEK16.9 billion) 2008: SEK3.7 bil. 2009: SEK8.3 bil. 2010: SEK6.2 bil. 2011: SEK4.0 bil. 2012: SEK1.2 bil. 2013 and thereafter: SEK17.5 bil.	

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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