

REVIEW OF OPERATING ENVIRONMENT, STRATEGIES AND ACTIVITIES



Operating environment

The energy industry is in a new phase of development in which Vattenfall sees many opportunities:

- Ageing power plants in Europe and thus a growing replacement need are creating attractive opportunities to invest in new energy generation.
- Vattenfall's financial strength, adeptness at working in competitive markets and experience in integrating acquisitions make us well-positioned to act in a European energy market under consolidation.
- Our strong position in northern Europe can be further developed.
- Vattenfall's experience in various types of power generation form a strong base for developing the company's generation facilities toward greater efficiency and high demands on environmental performance.

But there are also challenges that must be tackled on the way to Vattenfall's vision of being a leading European energy company:

Increased focus on safety and environment

- In 2006 a number of disruptions occurred at the Forsmark nuclear power plant which led to extensive scrutiny and examination of safety issues and of the safety culture of the nuclear power operations. Vattenfall is of the firm conviction that safety always must be given top priority and that no conflicts whatsoever may exist between safety, generation and profitability. On the contrary, well documented and trustworthy safety and environmental work is a fundamental prerequisite for continued profitable growth.

Mounting competition

- Our competitors continue to expand and may gain more dominant positions in Vattenfall's home markets.
- Greater competition in electricity sales is putting pressure on margins.
- The growing convergence of electricity and gas presents a challenge for Vattenfall, which is one of the few European players that does not have any large-scale gas operations.
- A limited number of suitable acquisition candidates is leading to high prices, which affects our ability to grow through acquisitions.

Greater regulation

- Potential changes in rules and taxation, especially in heat and electricity networks, could affect Vattenfall's competitiveness and, by extension, hurt profitability.
- The energy industry's declining reputation among the general public could lead to stronger calls for regulation.
- Institutional decisions at both the European and national levels, such as the allocation of emission allowances and increased requirements for renewable electricity generation, could have an adverse impact on Vattenfall's profitability.



Strategies

Profitable Growth

Vattenfall's sales have more than quadrupled since 2000 at the same time that we have created favourable conditions for future growth. Profitable growth is essential if Vattenfall is to continue to be competitive, create value and be a positive force in the industry by contributing to sustainable development of society. Size carries a number of strategic advantages, such as market position, financial strength and ability to spread risks. On top of this are operational economies of scale in several areas, such as purchasing, IT, production and administration.

Benchmark for the Industry

Mounting competition and price pressure will be an enduring trend in the European energy market. To meet this challenge and maintain its competitive strength, Vattenfall must keep its focus fixed on operational efficiency and value creation. Vattenfall has streamlined its operations considerably in recent years, but this has mainly taken place at the regional and local levels. This work must continue. However, we must also take advantage of synergies and opportunities to improve efficiency between different regions and thereby be able to expand with continued good profitability.

Number One for the Customer

Vattenfall has nearly six million customers. Having satisfied customers who put their confidence in the company is both a necessity and prerequisite for fostering acceptance for the company's operations and being able to develop new solutions. The goal is to gain market shares at the same time that we increase customer satisfaction – all with maintained or improved profitability.

Number One for the Environment

Demands on the energy industry to contribute to sustainable development of society are constantly growing. Parallel with this, our knowledge is growing about the environmental problems that we must tackle. In pace with globalisation, technological development and a tendency towards more stringent legislation, the relevance of our ambition to be an environmental leader has been further underscored. Our aim is to find solutions that lead to efficient energy use and reduce emissions of carbon dioxide and other greenhouse gases. We are striving to take a leading role in renewable electricity and heat generation, and to maintain a world-class standard in every energy source and every technology we use.

Employer of Choice

Vattenfall's success requires that we have good leadership, the right expertise and energised employees. Vattenfall is facing a massive investment programme and a generation shift that will present major challenges. At the same time that experienced employees with unique know-how are leaving, students are showing a falling interest in technology. Vattenfall has the resources and strategies to create conditions to attract, develop and retain leading expertise, and to motivate employees to perform to their utmost.



Activities

- Continuously evaluate acquisition candidates and investments in expanded capacity and delivery ability. Geographic expansion will primarily take place in or around regions in which Vattenfall is already established. Growth will take place with a continued emphasis on being a vertically integrated energy company with focus on electricity production and heat. Natural gas has potential as an acquisition area, partly as a source of heat and electricity generation, and partly due to the growing convergence between the electricity and gas markets.
- Prepare and implement an extensive investment programme. By 2011 Vattenfall plans to invest SEK 134 billion, of which roughly SEK 102 billion in generation capacity.
- Reduce costs per customer ("cost to serve").
- Expand efficiency-improvement work to cover the entire organisation; identify and implement best practice in as many areas as possible.
- Continuously improve follow-up systems.
- Execute strategies for achieving economies of scale in IT investments and purchasing.
- Continue to improve and centrally co-ordinate investment planning.
- Ensure competitive pricing while providing the best possible service. Projects are under way to improve and simplify customer service. Customer satisfaction is being continuously measured in order to be able to take improvement actions.
- Offer long-term contracts to industrial customers.
- Improve co-ordination of customer service between the various business units.
- Adapt the product portfolio in order to meet changed customer needs, such as through electricity and gas offers ("dual fuel") in Germany.
- Create a cohesive brand for all parts of Vattenfall in an effort to serve customers better and more clearly, with one face to the customer.
- Invest in energy production that generates low or no carbon dioxide emissions (such as nuclear power) and in technology for reducing emissions from fossil fuel-fired power plants. Increase capacity of existing facilities that generate low carbon dioxide emissions.
- Invest in wind power and biofuel-based electricity and heat generation, assuming attractive commercial conditions.
- Invest in new turbine wheels when refurbishing hydro power plants with better environmental qualities and higher generation.
- Increase efficiency in the generation and transmission of electricity.
- Create better systems and processes for directing and following up environmental work.
- Strengthen leadership through a first rate leadership succession process and Group-wide management development programmes.
- Implement long-term strategic competency planning throughout the Group.
- Continuous development of employees' competence, with commercial needs as a starting point.
- Conduct the "My Opinion" employee survey once a year to gain documentation for improvements and strengthen employee commitment.
- Offer all employees a safe, healthy and stimulating work environment.
- Continue developing flexible pay models and incentive programmes that support the Group's long-term objectives.



Achieved 2006

- Consolidated Danish generation assets, increasing Vattenfall's annual heat and electricity generation by approximately 6 TWh each (read more on page 4).
- Acquired the Vanaja combined heat and electricity power plant in Tavastehus, Finland (150 MW heat and 60 MW electricity).
- Adopted a number of Key Performance Indicators (KPI) for following up the various business units at the Group level.
- Established a joint service unit in Germany by combining the service units in Berlin, Hamburg and Cottbus.
- Implemented the joint "Vattenfall Business Services Nordic" unit for the Nordic countries.
- Established the new "Capacity Management" staff function (see also page 68 under Investment risk), in order to achieve stronger management of the focus and priorities of investment projects within the Group.
- Began work on a Group-wide IT platform and continued work on harmonising all of the Group's websites in a measure aimed at supporting a cohesive brand for Vattenfall.
- Launched "Trygghetsavtalet", a three-year fixed-price contract in Sweden with a favourable renewal option (see page 5).
- Carried out an energy efficiency-improvement campaign, introduced 24-hour customer service and a price guarantee programme in Germany.
- Streamlined and improved customer service in Poland (see case on pages 44-45).
- Continued to improve delivery quality to customers by isolating the medium-voltage grid in the Nordic countries.
- Successfully migrated the Vattenfall brand to our German and Polish subsidiaries, which now operate under the Vattenfall name, enabling us to act as One Vattenfall toward customers.
- Commissioned a new biofuel-fired combined heat and electricity plant (17 MW heat and 3.5 MW electricity) in Motala, Sweden, with a lower CO₂ footprint.
- Started construction of Vattenfall's pilot CO₂ emission-free power plant in Germany (read more on page 4).
- Restoration of natural landscape and flora on a 200 hectare site alongside the Spree River in Germany.
- Complete sulphur cleansing at the Prusków power plant in Poland, one of Europe's largest combined heat and electricity plants, and decision to stop depositing ashes at the Zéràn combined heat and electricity plant in Warsaw.
- Presented a model for reducing global CO₂ emissions in a report entitled "Curbing Climate Change".
- Established four competence centres to optimise knowledge-sharing between various units and countries in an effort to take effective action at an early stage.
- Vattenfall ranked as Sweden's best employer among young professionals who evaluated their own employers in Universum Communications' Young Professionals survey.
- Annual employee survey points to major advances made in several important areas, such as goals and feedback, work/life balance and leadership.
- Collective agreement reached for the core business in Germany.
- Completed evaluation and performance reviews of 1,458 managers and potential managers.
- Participation of some 300 employees in Group-wide leadership development programmes.
- Establishment of Vattenfall Business Institute, which offers Group-wide programmes in business control, purchasing, HR and specialist areas.