

WELL ON THE WAY TO REALISING OUR VISION

After the extensive acquisitions that Vattenfall initiated about five years ago, recent years have been characterised by financial and operational consolidation. Profitability in the Group and business units has been followed up through the Close the Gap programme. In Germany, comprehensive consolidation work has been conducted with the acquired operations.

At the end of 2004, Vattenfall had achieved all previously established Group targets for consolidation work. Vattenfall is therefore ready for the next phase towards the vision to become a leading European energy company.

We shall continue our current profitable growth. Growth shall mainly take place through acquisitions, but also through the expansion of our own generation capacity.

Parallel to this, we will continue our work to strengthen the Group's competitive edge. During 2005 and thereafter, Vattenfall will continue to the next step in the integration work with the acquired units – realising synergies across national borders and establishing 'One Vattenfall'. Joint Group projects are already underway for this express purpose. We shall also continue the work to become 'Number one' for the customer and the environment and to be an attractive employer.

Our objective is that Vattenfall shall become the benchmark company that our industry sees as a good example and as a measure of success.

Follow-up of the challenges of 2004

Gap closing

For three years, Vattenfall has conducted a profitability programme called 'Close the Gap'. The gap referred to is the difference between our long-term requirement of a return on net assets of 11 per cent and our attained return. The requirements are then split between the business units based on the criteria relevant to each unit. The profitability programme has been a success and resulted in greatly reduced costs and improved cash flow. Most business units reached their targets in 2004. As a whole, the Group fulfilled the goal of reporting a total return of 15.2 per cent.

Integration of acquired operations

Through the acquisitions in Germany and Poland in 2000–2003, Vattenfall more than tripled its sales. At the time of the acquisitions, profitability in the acquired units was very much poorer than Vattenfall's profitability requirement and intensive consolidation work was initiated. In 2004, the integration process in both Germany and Poland continued to develop positively. Germany exceeded its target operating profit for the year. Profitability in our Polish operations is still below target, but profit improved markedly in 2004, much due to continued cost reductions.

Focus on core activities

Vattenfall's core business encompasses the entire value chain from generation to sale. Operations that do not belong to core activities within electricity and heating, or that are not expected to achieve the profitability requirements within a reasonable time, may be divested. In 2004, Vattenfall sold all shareholdings in A-train, as well as the shares in the Russian company Mosenergo and the Chinese company Hebei Hanfeng Power Generation.

Continued reinforcement of risk management

The deregulation of the energy markets has placed new and increased demands on energy companies' risk management. The electricity price risk is one of the most central in this market, although the management of other risks, such as political risk, environment risk and operational risk, is also important for the company's continued

success. At Vattenfall, risk management is performed on an ongoing basis and among the more major changes during 2004 we can mention the creation of a joint Group trading unit, Vattenfall Trading Services, headquartered in Hamburg.

Increased investments in security of supply

During 2004, Vattenfall worked hard to improve the security of supply. In Sweden, a five-year investment and maintenance programme totalling SEK 10 billion is underway in order to, among other things, run cables underground and insulate them. In Germany, work has begun to strengthen the high-voltage network in order to cope with the input from wind power generation.

Active role to improve the environment

Demands from the public, politicians and customers regarding sustainable development in society are greater than ever. Even formal requirements from the EU increase the demands on energy generation, through, for example, trading in emission allowances. Vattenfall plans to invest within the areas of renewable electricity generation by building a large off-shore wind power park in Öresund, off the coast of Skåne in the south of Sweden. Vattenfall also invests considerable sums in increasing the power output of existing nuclear – and hydro power plants, generation that causes almost no emissions.

'Number one for the customer' efforts continue

Being 'Number one for the customer' is one of the most important challenges for Vattenfall. Since 2002, a pilot project has been underway in Sweden and Finland for increasing customer satisfaction with improved service, quality and customer care. Among other things, easier to read electricity bills were introduced and remote-readable electricity meters were installed. An end to invoicing Swedish household customers in arrears for electricity consumed more than a year ago and the introduction of a Customer Ombudsman in Sweden are other investments intended to strengthen the customer's position.

2005 AND BEYOND

Even if 2004 was in many ways a record year for Vattenfall, there is still much to do on the path towards our vision. Profitable expansion and integration with acquired companies will continue. As will the work with our customers, the environment and our employees, –all of which have a central role in our work to become the industry benchmark.

Continuing with profitable growth

Our long-term goal is to increase our market share in the integrated European energy market (EU 25 and Norway and Switzerland). We expect continued pressure to cut prices within the industry. Through further expansion, Vattenfall intends to meet the demand for price-cutting by continuing to realise cost synergies and strengthening our position in the market, thereby improving our position as regards our competitors.

We expect our expansion to continue in both our current primary markets and in the neighbouring countries, such as Norway, Denmark, Benelux, France, Switzerland, Austria and the Czech Republic. Even if Vattenfall still strives to be an integrated power company, we take a positive stance towards possibilities to increase our generation capacity. Vattenfall already has a strong position within electricity generation and heat production and additional expansion could strengthen our position in the wholesale link of the chain. We expect acquisitions to provide the majority of growth, but also plan to expand existing production plants.

Generation and sales of electricity and being active within the entire value chain for heat will continue to be our focus areas. We also consider gas to be an interesting area as growth is expected to exceed that of the market in general and gas will increasingly contribute to electricity generation and heat production. In order to gain a good competitive edge within gas, the capacity to purchase large volumes is required, so large size will be a prerequisite in this area too.

Business performance: Benchmark of the industry

Vattenfall's vision is to be a leading European energy company. Size is an important competitive advantage in our market in order to be able to utilise economies of scale. With the acquisitions in Germany and Poland, a step was taken towards this vision when Vattenfall's sales

were trebled. Size, however, is only one aspect of being leading. Leading also means being the benchmark company, the measure with which other companies in the industry compare themselves.

So far, work with acquisitions has mainly been focused on attaining lower costs per generated unit by incorporating, optimising and concentrating units in the Group. This work is almost complete. For Vattenfall's part, the major challenge remains to make greater use of the substantial synergies found in our operations.

The next step in development is therefore to fully utilise the available possibilities in terms of both cross border economies of scale and the use of collective knowledge within the Group. The goal is that each segment of Vattenfall's operations shall be able to serve as a benchmark within our industry.

The synergies that Vattenfall expects to realise are economies of scale, such as within purchasing and IT infrastructure, and knowledge base advantages, such as within risk management and maintenance. Several programmes are already underway in these areas. Vattenfall Trading Services provides one example of how risk management in generation and sales can be optimised. Within the area of maintenance, a programme is underway with the ambition of improving efficiency and quality. Other ongoing programmes include the centralisation of fuel management, a review of administrative functions and the development of joint Group key figures for comparative purposes.

In order to increase knowledge exchange within the Group, several benchmarking projects have been initiated, such as within electricity networks and heating operations.

Customers, the environment and our employees 'Number one for the customer'

Today, Vattenfall has approximately six million customers. All of our operations are dependent on their trust. In the Nordic countries, for example, the entire energy sector has for some time now been met by much distrust from

- Continued profitable growth
- Business Performance:
Be the benchmark of the industry
- Become 'Number one' for the customer and the environment
- Be the employer of choice

consumers. If we are to be able to develop our business, we must gain broad and solid trust from our customers. To this end, over the coming years we will continue to invest in becoming 'Number one for the Customer'. Based on Vattenfall's extensive knowledge and experience of deregulated markets, with their demands for high levels of service and accessibility, we will continue to work aggressively to become the first choice for energy customers.

'Number one for the environment'

The most serious environmental problem of our time, the ongoing climate change, is a global problem. Vattenfall is working to improve the environment and our ambition is to become the industry leader within environmental issues within the areas covered by our operations. Our coal-fired generation plants in Germany are among the world's most modern and provide, with the exception of carbon dioxide, limited emissions to the atmosphere. Almost half of our total electricity generation comes from renewable energy sources, such as hydro, or nuclear power, generation which generally have very low emissions and release practically no greenhouse gases.

This, however, is not sufficient. Within the EU, far-reaching measures, based on the Kyoto protocol, have long been planned to reduce carbon dioxide emissions and at the beginning of 2005, trading in emission allowances began.

We continue our work to optimise our plants, to increase the use of energy sources with low or no emissions and to be a driving force in the development of the carbon dioxide-free coal-fired power plant to strengthen our position on environmental issues, in line with our ambition to become 'Number one for the environment'.

An attractive employer

Dedicated and competent employees have an important role in Vattenfall's development. Our ability to attract, involve and develop the employees and competence that we need is therefore a highly prioritised area. Especially with consideration for the fact that many Vattenfall employees will retire over the next ten years. Vattenfall will continue to work intensively with both managerial and competence development. At present, a number of joint Group projects are underway, including a project intended to create a common idea of leadership.