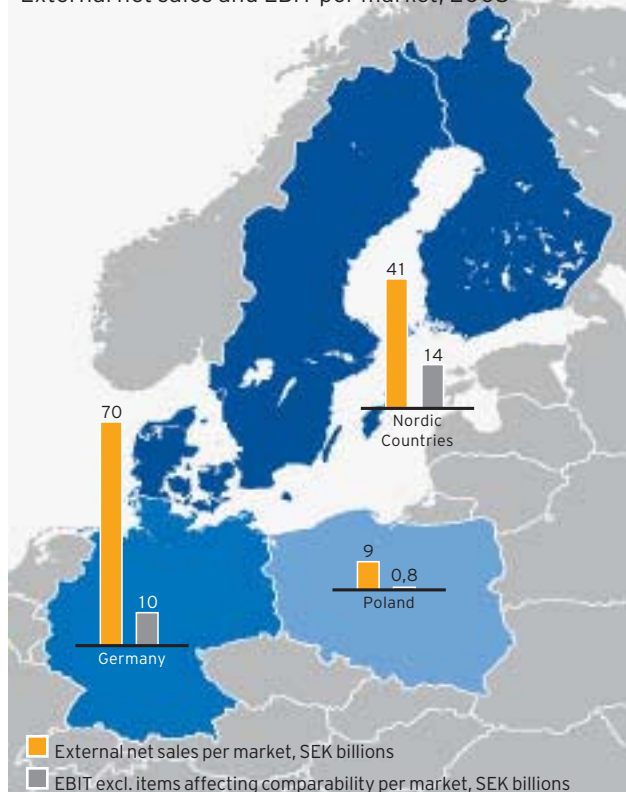


ANNUAL REPORT 2005

A hand is shown in silhouette, holding a large, five-pointed starfish. The starfish is illuminated from behind, creating a bright, glowing effect. The background is a sunset over the ocean, with the sun low on the horizon and its light reflecting on the water. The sky transitions from a deep blue at the top to a warm orange and yellow near the horizon.

FIVE AMBITIONS FOR
BECOMING NUMBER ONE

External net sales and EBIT per market, 2005



Vattenfall's markets

Nordic Countries

Vattenfall generates roughly 20 per cent of the electricity consumed in the Nordic countries. Electricity generation is almost exclusively comprised of nuclear power and hydro power. Electricity is sold to approximately 0,9 million customers throughout the Nordic countries. Vattenfall also has considerable heat generation operations, largely based on biofuel, and sells district heating and so-called thermal heat. Distribution owns and operates electricity networks and distributes electricity to 1.3 million network customers in Sweden and Finland. Vattenfall also conducts consulting, contracting and R&D activities, primarily within the energy sector.

Germany

Vattenfall generates almost 14 per cent of the electricity consumed in Germany, making it the country's third largest generator of electricity. About 87 per cent of the generation comes from fossil fuels, primarily based on the company's own lignite mining. Vattenfall's coal-fired power plants are among the most modern in the world. Vattenfall also generates heat and has considerable district heating sales, primarily in Berlin and Hamburg. In the electricity network sector, Vattenfall owns and operates high-voltage as well as regional and local networks. There are a total of about 3.4 million network customers and about 2.9 million electricity customers.

Poland

Heat generation and sales comprise the majority of operations and Vattenfall has a market share of about 27 per cent. Electricity is also generated, but to a lesser degree. Distribution owns and operates electricity networks and distributes electricity to 1.1 million network customers, primarily in the south-western part of the country. There are a total of approximately 1.1 million electricity customers.

Joint Group operations

Vattenfall Trading Services, Vattenfall Treasury and Vattenfall Insurance are central support functions for managing the Group's risks and providing market access.

Key facts about Vattenfall's markets

	Nordic Countries		Germany		Poland		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
External net sales, SEK millions	40,712	38,843	70,304	63,514	8,790	7,421	129,158 ¹	113,366 ²
Operating profit, SEK millions	16,845	12,215	10,221	4,591	842	711	27,730 ³	17,112 ⁴
EBIT excl. items affecting comparability, SEK millions	13,755	12,246	10,359	7,208	808	691	24,744 ⁵	19,327 ⁶
Net assets, SEK millions	77,190	57,377	68,717	68,040	9,295	7,321	155,237	131,622
Electricity generation, TWh	89.8	88.4	75.9	75.5	3.4	3.2	169.1	167.1
Heat, TWh	7.3	7.6	15.4	15.5	11.4	11.4	34.1	34.5
Number of customers	1,291,000	1,278,000	3,399,000	3,393,000	1,104,000	1,101,000	5,794,000	5,772,000
Number of employees	8,788	8,735	20,096	20,864	3,029	3,309	32,231 ⁷	33,017 ⁸

1) Total sales includes sales in "Other segment" of SEK 9,352 million. 2) Total sales includes sales in "Other segment" of SEK 3,588 million. 3) Total profit includes a loss in "Other segment" of SEK -178 million. 4) Total profit includes a loss in "Other segment" of SEK -392 million. 5) Total includes a loss in "Other segment" of SEK -178 million. 6) Total includes a loss in "Other segment" of SEK -805 million. 7) Other countries are included, totalling 318 persons. 8) Other countries are included, totalling 109 persons.

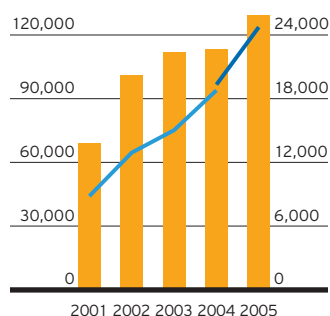
THIS IS VATTENFALL

Vattenfall is Europe's fourth largest generator of electricity and the largest generator of heat. The Group's sales amounted to SEK 129,158 million in 2005. Vattenfall's vision is to be a leading European power company. The company currently has operations in Sweden, Finland, Denmark, Germany and Poland. Vattenfall is active at all stages of the electricity value chain – generation, transmission, distribution and sales. Vattenfall is also active in electricity trading and generates, distributes and sells heat. The group has more than 32,000 employees and the parent company, Vattenfall AB, is wholly owned by the Swedish State.

Sales and operating profit

Sales, SEK millions
150,000

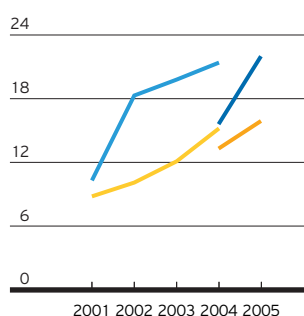
Operating profit, SEK millions
30,000



■ Sales (IFRS)
 ■ Operating profit¹ (Sw. GAAP)
 ■ Operating profit¹ (IFRS)
 1) Excl items affecting comparability.

Profitability

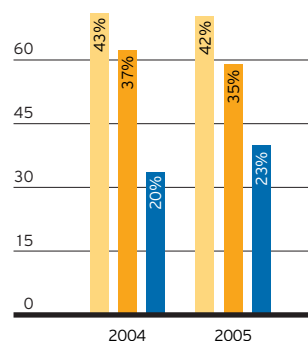
%
30



■ Return on equity¹ (Sw. GAAP)
 ■ Return on equity¹ (IFRS)
 ■ Return on net assets¹ (Sw. GAAP)
 ■ Return on net assets¹ (IFRS)
 1) Excl items affecting comparability.

Total electricity generation¹

TWh
75



■ Fossil-based power
 ■ Nuclear power
 ■ Hydro power
 1) Wind power, biofuel and waste are included in these volumes at a total of 0.6 TWh for 2004 and 0.5 TWh for 2005.

Key figures (IFRS)

	2005	2004	2005 (EUR) ¹
Net sales, SEK millions	129,158	113,366	13,697
Operating profit, SEK millions	27,730	17,112	2,941
Operating profit (EBIT) excl. items affecting comparability, SEK millions	24,744	19,327	2,624
Profit before tax, SEK millions	26,319	14,614	2,791
Profit for the year, SEK millions	20,518	9,604	2,176
Earnings per share, SEK	146.05	67.91	15.49
Return on equity excl. items affecting comparability, %	22.0	15.6	
Return on net assets excl. items affecting comparability, %	15.9	13.3	
Total assets, SEK millions	330,421	285,205	35,039
Equity/assets ratio, %	26.8	29.1	
Funds from operations (FFO), SEK millions	31,386	24,302	3,328
Investments, SEK millions	24,497	12,731	2,598
Electricity generation, TWh	169.1	167.1	
Heat generation, TWh	34.1	34.5	
Average number of employees in the Group	32,231	33,017	

1) Exchange rate 9.43 SEK/EUR.

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Financial calendar 2006

8 February	Year-end Report
Mid-March	Annual Report 2005
27 April	Three-month Interim Report
27 April	Annual General Meeting
27 July	Six-month Interim Report
31 October	Nine-month Interim Report

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Other publications

September Corporate Social Responsibility Report
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Further information about Vattenfall can be found on Vattenfall's homepages:

www.vattenfall.com (English)
www.vattenfall.se (Swedish)

Now we are concentrating our efforts from the position of a strong and cohesive brand, our values and the conviction that a company performs better when it acts responsibly. During 2005, Vattenfall continued to improve performance and streamline operations further. Now we are prepared for the next step – to realise our vision of being a leading European energy company with good growth and profitability.

In order to take the next step we must make several strategic priorities. These are our five strategic ambitions:

To continue the profitable growth



To be the benchmark for the industry



To become "Number One for the Customer"



To become "Number One for the Environment"



To be the employer of choice



VATTENFALL TODAY, TOMORROW AND THE DAY AFTER TOMORROW

2005 was a new record year for Vattenfall. Operating profit, excluding items affecting comparability, increased by 28 per cent to SEK 24,744 million and sales increased by 13.9 per cent to SEK 129,158 million. Good water supply in Sweden combined with our generation mix produced high volumes at low cost. The goals we set at Group level have been attained and most of our operations reported improved financial performance. We have also benefited from higher wholesale electricity prices and improved hedging results. Record-high oil and gas prices in Europe led to increased use of coal in electricity generation, driving up the price of emission allowances for carbon dioxide, and consequently, also electricity wholesale prices. The European trading system for emission allowances, introduced in January 2005, has functioned well, but due to high oil and gas prices, emission allowance prices have remained much higher than many analysts expected.

Vattenfall has been incorporated since 1 January 1992. Operating profit that year was SEK 5,590 million and sales SEK 22,431 million. In 1999, operating profit was SEK 5,515 million and sales SEK 27,754 million. During the past five years, the company's operations have grown considerably by means of extensive acquisitions in Germany and Poland while operations outside Europe have been divested. During the year, Vattenfall established an important position in combined heat and power and wind power in Denmark. Strategically, the acquisition in Denmark is an important one, and means that our core business of electricity generation and our operations in the Nordic countries are strengthened while also providing increased opportunities for cross-border trade between the Nordic countries and Germany.

Growth is good for the customer

This growth enables us to use our available resources more effectively. Growth also provides a broader knowledge base for more innovative solutions, more efficient processes and improved product and service offerings to our customers. The strong set of annual accounts for 2005 confirms that our growth-strategy

is the right one. If used sensibly, size can provide considerable advantages.

The results should be seen in relation to the resources, the capital, for which we are responsible. The power industry is extremely capital-intensive. In addition to large sums of invested capital, Vattenfall has extensive knowledge capital, based on wide-ranging operations within electricity and heat. We are active throughout the value chain in four countries. These operations are essentially local. In total, we have in excess of 32,000 employees. The breadth and depth of their knowledge and competence is the true secret of our success. We have almost six million customers in Sweden, Finland, Poland and Germany. The Swedish people, nine million citizens, own the company. As of 2006, we operate under a common united brand in all countries to manage and develop more effectively the position of trust we have earned.

An important prerequisite for Vattenfall's development is the increasing openness of the European electricity markets. Deregulation has introduced the companies to market forces; the business logic of the power industry has fundamentally changed. The electricity sector has evolved from an almost feudal structure to open and internationalised markets in less than ten years. Deregulation and the integration of the energy markets is an important part of creating a competitive Europe that will maintain its position in an increasingly globalised world. Globalisation will continue to transform both electricity and other energy supplies. The European Union is facing its next major step in the energy sector. And the goal is clear. We need to ensure efficiency and competition in combination with sustainable solutions and a reliable power supply. This demands major investments and companies willing to take risks – and Vattenfall is one of them.

All business units create value

Vattenfall's business model is based on a value chain, that is, every part shall support itself and thereby create value. Settlements between business units shall take place on market terms. Each part creates value



through efficient operations. All our business units aim to be leading in their fields. In order to measure our success, we introduced our Key Performance Indicators (KPI). We have created a positive development spiral linked to market development. However, this is only the beginning, as the market and the world around us continues to change.

Power supply is global, in terms of both supply and demand. The greenhouse effect and measures to deal with it require joint efforts from all of humanity. A secure power supply demands an open global economy based on mutual acceptance and understanding. Well functioning open markets are necessary to achieve social-economic efficiency. This development requires that every part of the value chain covers its own costs – environmental costs and other

external effects must come at a price; compound subsidies must be abolished.

We are facing major challenges

Power companies are facing major challenges. Market conditions, and therefore energy prices, are changing. Taxes and economic means of control are becoming a larger part of the consumer's energy price. Most factors indicate that energy will become a resource of ever increasing value. This will lead to gradual adaptations in customer consumption patterns and improved energy efficiency. The energy supply is also facing major technical challenges. Carbon dioxide-free technology based on renewable energy sources, the separation and storage of carbon dioxide and new nuclear power are of inter-

national interest. We will see new solutions and more advanced facilities with increasing greater demands regarding functionality. The demands on business and its role are undergoing great changes. The power companies of today and the future need to be extremely competitive and also – well informed – about the world in which they operate.

At Vattenfall, we perceive this wave of change as a series of opportunities. The challenges must be transformed into commercial activities; which requires that the solutions must be in place for when the right market conditions arise. We are committed to continually develop our resource base to take advantage of these opportunities. Long-term investments and risk-taking requires large-scale companies that can combine competence with financial resources. This annual report shows that we are now considerably better equipped than we were five years ago. We are investing in future technologies, in a proactive role in the market and in an open dialogue with the world around us. By standing for modern and successful business, we can realise our vision to be a leading European energy company.

Energy solutions for a sustainable development

Our ambition is to run our plants in the best possible way and to stay a step ahead of the competition. It is about everything from environmental efficiency in our daily work to investments in major changes. In 2005, we took some important steps. We have declared our ambition in the shape of a new environmental policy. According to this policy we shall, when making investments, make a sound assessment balancing environment and economy. We shall also do our utmost to choose modern, efficient and environmentally-effective technologies.

We have decided to invest in a pilot installation to develop carbon dioxide-free coal-fired power technology. Construction at our Schwarze Pumpe plant in eastern Germany will begin this summer. Dealing with the greenhouse effect in a responsible manner demands a global price for carbon dioxide. Vattenfall has been deeply involved in this issue: in January 2006, we published a report entitled “Curbing Climate Change – An outline of a framework leading to a low carbon emitting society” (the report can be downloaded from www.vattenfall.com). We will continue to work to persuade our industry, and trade and industry as a whole, to act together on this issue and demand a sustainable market-based global solution.

It is our job and our responsibility to contribute to the development of energy solutions suited to sustainable societal development. Such solutions must include consideration for nature, customers, employees and society in general. This requires size and financial clout. Vattenfall's knowledge about customers, technology and the market contributes to a more effective energy supply in Sweden as well as in Europe. Vattenfall represents innovative thinking in the European energy sector. We have taken the decisive step on the chosen path and our success ensures that we can continue to grow. Our five strategic ambitions, a recurring theme in this annual report, will guide the way. By being the best we will become leading. Today's resources, wisely used, will create additional resources for both tomorrow and the day after tomorrow.



Lars G Josefsson
President and Chief Executive Officer

IMPORTANT EVENTS

Storm caused major network disruptions

In January 2005, southern Sweden was hit by a widespread storm with hurricane-force winds. The damage to forests, infrastructure and the electricity network was enormous. Vattenfall's costs for network repairs, disruption guarantees, damages and additional work amounted to more than SEK 500 million.

Major acquisition in Denmark

In April, Vattenfall acquired 35.3 per cent of the shares in the Danish company Elsam for approximately SEK 10.3 billion. In June, an agreement in principle was signed with the Danish oil and gas company Dong in which Vattenfall, in exchange for shares in Elsam and our holdings in Avedöre 2, acquires production assets. (Read more on pages 36 and 64).

Open annual general meeting

On 26 April, Vattenfall held its first open annual general meeting. Previously, the meeting had only been open to members of the Swedish parliament. More than 250 people attended the meeting. After the formal procedures, the public was offered the opportunity to pose questions directly to the Chairman of Vattenfall's Board of Directors and Chief Executive Officer.

Closure of Barsebäck

In line with government decision and current law the Swedish nuclear power plant Barsebäck 2 was closed down on 31 May. Following negotiations between the Swedish state, E.ON and Vattenfall, an agreement was signed in November on fair compensation for the loss of production from Barsebäck 2 (see page 65).

Pilot installation for a carbon dioxide-free coal-fired power plant

In May, Vattenfall announced that it will build the world's first installation for a carbon dioxide-free coal-fired power plant based on so-called oxyfuel technology¹. The installation will be built adjacent to

1) Carbon dioxide from the combustion process is captured, liquefied and finally stored in the bedrock.

Vattenfall's coal-fired power plant Schwarze Pumpe in eastern Germany with an investment of approximately SEK 370 million. The plant is expected to be put into operation in 2008.

Investment in wind power

In October, Vattenfall decided to build a wind power farm at Lillgrund in Öresund. Lillgrund represents the largest investment in wind power in Sweden and one of the largest in Europe. Vattenfall has also acquired the rights to develop the Swedish part of Kriegers Flak in the Baltic Sea.

New energy law in Germany

On 13 July, the new German energy industry act (EnWG) came into force. As a result, the new German network regulator, Bundesnetzagentur, was able to begin its work. Initially, all tariff changes must be approved in advance by the regulator. The aim is to make the transition to an incentive-based regulatory model in 2007.

Squeeze-out of minority shares in Germany

In August, Vattenfall announced that its shareholding in the listed German subsidiary Vattenfall Europe AG exceeds 95 per cent. In December, the decision was made to hold an extra general meeting in March 2006 at Vattenfall Europe AG for a decision on the squeeze-out of the minority owners' shares.

A common brand is being built

On 1 January 2006, Vattenfall's German subsidiaries Bewag and HEW, as well as the Polish subsidiary EW was renamed Vattenfall and in Vattenfall's Polish subsidiary GZE the business units now operate under the Vattenfall brand.

Increased energy taxes in Sweden

The Swedish parliament decided to increase property tax on hydro power as well as the tax on installed nuclear power capacity, effective 1 January 2006. For Vattenfall, this entails increased annual costs of approximately SEK 1.5 billion.

THE YEAR IN BRIEF

Sales increased by 13.9 per cent to SEK 129,158 million (113,366)

Net sales, quarterly

SEK millions

50,000

40,000

30,000

20,000

10,000

0

2003 2004 2005

Sales increased primarily as a result of higher electricity wholesale prices in Germany, somewhat higher sales volumes in the Nordic countries and Poland and exchange rate effects, i.e. stronger EUR and PLN.

Earnings per share increased by 215 per cent to SEK 146.05 (67.91)

Free cash flow totalled SEK 14,341 million (15,684)

Free cash flow¹, quarterly

SEK millions

7,500

6,000

4,500

3,000

1,500

0

2003 2004 2005

Investments

SEK millions

25,000

20,000

15,000

10,000

5,000

0

2003 2004 2005

■ Maintenance investments
■ Growth investments

1) Cash flow from operating activities minus maintenance investments.

Operating profit, excluding items affecting comparability, increased by 28.0 per cent to SEK 24,744 million (19,327)

Operating profit, quarterly

SEK millions

12,500

10,000

7,500

5,000

2,500

0

2003 2004 2005

The increase in operating profit is primarily attributable to Germany, although the Nordic countries and Poland have also showed improved operating profits. The improvement in Poland, however, is mainly due to exchange rate effects, i.e. stronger PLN.

Net debt increased by SEK 8.9 billion to SEK 64.3 billion compared to the previous year

Net debt increased primarily due to the acquisition of shares in the Danish power company Elsam (SEK 10,325 million) and the distribution of a large dividend to the owner, the Swedish state (SEK 5,600 million).

Indebtedness

SEK millions

100,000

80,000

60,000

40,000

20,000

0

times

1,5

1,2

0,9

0,6

0,3

0

2003 2004 2005

Net debt, quarterly

SEK millions

100,000

80,000

60,000

40,000

20,000

0

2003 2004 2005

■ Net debt
■ Total liabilities
■ Debt/equity ratio, net, times (Sw.GAAP)
■ Debt/equity ratio, net, times (IFRS)

Financial targets

Outcome

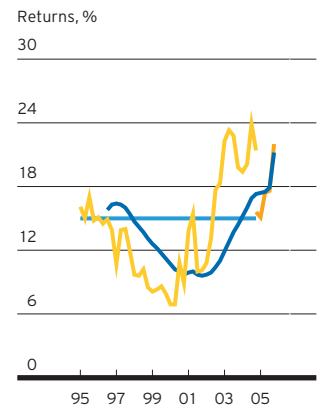
Profitability

The owner's long-term profitability goal is 15 per cent on equity after tax. Recalculated into the Group's required return on net assets (RoNA) this corresponds to 11 per cent before tax.

- Return on equity after tax¹ for 2005 amounted to 22.0 per cent (15.6).
- Return on net assets¹ amounted to 15.9 per cent (13.3).

- Return on equity after tax, rolling four-quarter values (Sw. GAAP)
- Return on equity after tax, rolling four-quarter values (IFRS)
- Return on equity after tax, rolling four-year values (Sw. GAAP to Q3 2004)
- Target return, 15%

1) Excl. items affecting comparability.



Rating

Vattenfall's intention is to maintain a credit rating in the single A category.

- Moody's upgraded Vattenfall's rating from A3 to A2 as a result of its new Government Related Issuer (GRI) methodology. Both rating agencies changed their outlook from stable to positive.

	Long-term		Short-term	
	Moody's	S&P	Moody's	S&P
2005	A2	A-	P-1	A-2
2004	A3	A-	P-2	A-2
2003	A3	A-	P-2	A-2
2002	A3	A-	P-2	A-2
2001	A3	A-	P-2	A-2

Dividend policy

The intention is to maintain a stable, long-term dividend which, under during normal circumstances, shall equal one third of net income.

SEK million	2000	2001	2002	2003	2004	2005
Profit for the year	2,970	4,190	7,566	9,123	11,776	16,178 ¹
Dividend	990	1,030	1,675	2,400	5,600	5,800 ²
% of net income	33.3	24.6	22.1	26.3	47.6	35.9

1) Excl. compensation for the closure of Barsebäck 2.
2) Proposed dividend.

Interest coverage

The owner's goal is that the interest coverage ratio shall be 3.5 to 5 times.

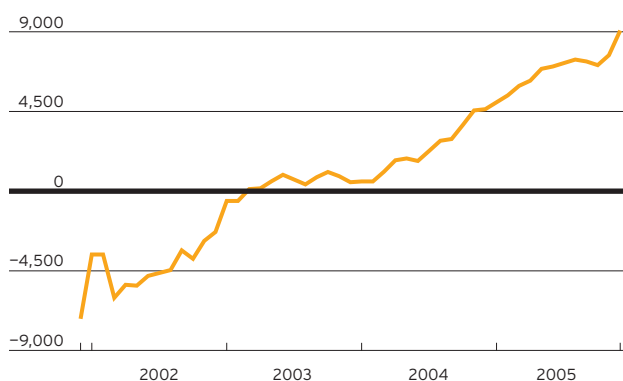
- The outcome excl items affecting comparability for 2005 was 8.4 times (5.9).

Value creation

The profitability requirement set by the owner is recalculated to individual targets for each business unit. The difference between the value created by the business unit and this requirement is called the Gap. If the outcome exceeds the required level, the business unit can look for profitable expansion possibilities.

Value creation

(Difference between results achieved and the Group's required return of 11% on net assets)
SEK million



STRATEGIES FOR EUROPEAN LEADERSHIP

After a period of rapid growth, Vattenfall has been working to consolidate its operations since 2001. This work has primarily consisted of two aspects: improving the company's ability to create value and to integrate and consolidate acquired companies. Both aspects have been carried out with successful results.

Future strategies will focus primarily on Vattenfall's vision: to be a leading European energy company. This shall be achieved primarily through profitable growth. At the same time, Vattenfall must continuously strive to maintain and further enhance operational efficiency in an industry where increased competition and price squeezing are expected to continue.

The power industry has entered a new development phase, one in which Vattenfall sees many opportunities, including:

- The aging state of power plants in Europe and the resulting need for replacement facilities creates interesting opportunities for investment in new power generation.
- Consolidation of the European energy market creates opportunities for new acquisitions.
- Our experience with competitive markets and with integrating acquired companies makes Vattenfall well equipped to act offensively.
- Our strong position in Northern Europe can be further developed.
- Vattenfall's experience with various types of power provides a strong base upon which to develop the company's production facilities in order to achieve increased efficiency and meet tougher environmental demands.

There are also challenges, however, to be faced on the road towards our vision, such as:

- Competitors continue to expand and can gain a more dominant position in Vattenfall's home markets.
- Possible changes to legislation and taxation can affect Vattenfall's competitive edge and ultimately decrease our profitability.
- Institutional decisions, on both European and national levels, such as those regarding the allocation of emission allowances, can affect Vattenfall's competitive edge negatively.

Vattenfall has formulated a number of strategic ambitions that govern future decision-making and investments. All of these have a common guiding principle: to contribute to our efforts to be a leading European energy company.

Our five strategic ambitions

To continue the profitable growth

The past five years have seen Vattenfall's sales quadruple, while we have simultaneously created a good platform for future growth. Profitable growth is required if Vattenfall is to continue to be competitive, to create value and to be a positive force in the industry with regard to contributing to sustainable development in society. Size provides a range of strategic advantages, such as market position, financial strength and the ability to balance risks. There are also operational advantages, such as more cost-effective procurement and more effective administration, which also increases profitability.

How?

- ✓ Regularly evaluate possible acquisitions and investments in increased capacity and ability to deliver. Geographic expansion will primarily take place in or around those regions where Vattenfall is already established.
- ✓ Grow with a focus – even in the future – on being a vertically integrated power company with a focus on the generation of electricity and heat. Natural gas can also be an attractive acquisition area, partly as a source for heat and electricity generation and partly with consideration for the increased convergence between the electricity and gas markets.

To become the benchmark for the industry

Increased competition and price squeezing will be an enduring trend in the European energy market. In order to meet this challenge, and to maintain our competitive edge, Vattenfall must continue to focus on operational efficiency and value creation. In recent years, Vattenfall has been considerably streamlined and we have reduced our costs, but this has primarily taken place on a regional level. The next challenge is to take advantage of the synergies and opportunities for optimisation throughout the company and in this way facilitate expansion while retaining good profitability.

- ✓ Broaden optimisation work to encompass the entire organisation.
- ✓ Continue to improve our follow-up systems.
- ✓ Implement strategies for taking advantage of economies of scale in IT investments and purchases.
- ✓ Further improve and centrally coordinate capacity management.

To become "Number One for the Customer"

Vattenfall has approximately six million customers. Having satisfied customers that have confidence in the company is both a requirement and a condition for gaining acceptance for the company's operations and being able to develop new solutions. The goal is for us to gain market shares while continuing to increase customer satisfaction – all the while with retained or improved profitability.

- ✓ Guarantee competitive pricing while providing the best possible service.
- ✓ Create a united brand covering all parts of our company in order to meet the customer in an enhanced and more distinct way.
- ✓ Simplify things for customers in all points of the sales chain.
- ✓ Measure and follow up on customer satisfaction in order to carry out improvement measures.
- ✓ Create coordination between customer service in all business units.

To become "Number One for the Environment"

The challenge for the energy industry is to contribute to the sustainable development of society while continuing to grow. At the same time, knowledge concerning the environmental problems we must face continues to grow. In light of globalisation, technology development and a transition to stricter legislation, the relevance of our ambition to lead the industry in environmental issues has been further underlined. Our goal is to find solutions that reduce carbon dioxide emissions and to have a leading role in renewable electricity and heat generation.

- ✓ Invest in energy production that generates little or no carbon dioxide emissions and technology to reduce emissions in the fossil-fired power plants.
- ✓ Increase capacity in existing facilities that do not generate carbon dioxide.
- ✓ Continue to invest in wind power and increase the proportion of biofuel, assuming attractive commercial conditions.
- ✓ Increase efficiency in the generation and transmission of electricity.
- ✓ Create better systems and processes for controlling and following up on environmental work.

To be the employer of choice

Vattenfall's success is dependent upon our having good leadership, the right competence and highly dedicated employees. Vattenfall is facing a generation shift that entails major challenges. At the same time that people with unique skills leave the company, students' interest in technology is decreasing. Vattenfall, however, has the resources and strategies to create the conditions required to attract, develop and retain leading expertise and motivate employees to perform to the best of their abilities.

- ✓ Strengthen leadership through a first-class management planning process and a Group-wide program for management development.
- ✓ Carry out long-term strategic competence planning throughout the Group.
- ✓ Develop employee competence on an ongoing basis, based on business requirements.
- ✓ Conduct the annual "My Opinion" employee survey in order to secure a basis for improvement work and strengthen employee commitment.
- ✓ Offer all employees a safe, healthy and stimulating working environment, on both the physical and psycho-social level.
- ✓ Continue to develop flexible compensation and benefit models that support the Group's long-term goals.



TO CONTINUE THE PROFITABLE GROWTH

"WE STEADILY INCREASE PROFIT WITH MORE EFFECTIVE PRODUCTION"

Doubled net sales per employee in comparison with our peers and successively reduced costs. Vattenfall Heat Poland (formerly EW) has gone from one success to another and now serves as a benchmark in the Polish energy market. During 2005, the company optimised energy generation by increasing the proportion of CHP, that is, the simultaneous generation of heat and electricity.

"Heat generation throughout all of the company's facilities is now complemented with electricity generation, which has steadily increased the volume of electricity. At the same time,

electricity prices have gone up as the market has been deregulated," says Jacek Drezewski, Managing Director of Vattenfall Heat Poland in Warsaw.

The result is clearly seen in the annual accounts: increasing profit (twofold increase since 2002) and successively increased generation of both electricity and heat. One important explanation of this positive earnings trend is a high level of cost awareness. Vattenfall Heat Poland works in a very structured manner to reduce all costs, through such measures as a Fuel Management System for optimising the amount of fuel in generation.



The most noticeable cost reductions, however, are due to more efficient production.

"We began our restructuring in 2001 and since then have rationalised all operations and outsourced major parts of our service organisation," Jacek Drezewski explains.

In 2002, Vattenfall Heat Poland had almost 3,000 employees – today the number is down to little more than 1,200 people.

"We have slimmed our organisation considerably and can probably continue to do so a little more before we are done. Now we are focusing purely on our core activities: generating heat and electricity," says Jacek Drezewski.

In accordance with the EU's directives, all countries in the Union shall have a deregulated electricity market by 2007. When this takes place in Poland, Vattenfall Heat Poland must be just as prepared as its strongest competitors.

"There's still a long way to go before the liberalisation of the Polish market is completed. There's a certain amount of resistance in some companies."

"But our company is ready for the future and we can meet this challenge from a strong market position," concludes Jacek Drezewski.

Major investment in Denmark

In June 2005, after a few months negotiations with the energy company Dong, an agreement was in place for Vattenfall to take over 24 per cent of the generation capacity in the Danish companies Elsam and E2.

"In addition to the fact that we see this as an investment in an effective and profitable operation that fits in well with our strategy for the Nordic countries, Denmark also brings together our primary markets in the Nordic countries and Germany," says Mikael Kramer, Head of Mergers & Acquisitions at Vattenfall.

The purchase entails Vattenfall taking over the five coal and gas-fired CHP plants as well as a large portion of the wind turbines, corresponding to 24 per cent of generation capacity at Elsam/E2. Annual generation from the plants is 6 TWh electricity and 6 TWh heat.

"The development from a national to a European energy market means it is necessary to continue to grow if we are to maintain our position and be able to reach our vision of being a leading European power company," says Mikael Kramer.

The deal also strengthens Vattenfall's investment in renewable energy sources. With one blow, Vattenfall's wind power capacity increases by a factor of twenty and the company becomes one of Europe's five largest producers of wind power.

THE ENERGY MARKET IN TRANSITION

In 2005, a new trading system was introduced for emission allowances for carbon dioxide in the EU, which clearly has affected electricity prices. The European electricity market still has a certain excess capacity, but in the long-term, new power plants will be needed.

Highly regulated historically, the energy sector has changed radically in the past 15 years. Deregulation and internationalisation, largely driven by the EU, has resulted in several electricity markets now being totally open to competition (see map on page 13). According to the EU Electricity Directive, the intention is for all countries to have deregulated their electricity markets and have totally opened them to competition by 1 July 2007 at the latest.

The differences in how far the various countries have progressed with this deregulation are still substantial and as a result the European Commission continues to drive development and integration across borders. The goal is to increase competition and integrate national markets into larger regional markets.

The intention is also for the natural gas market to be deregulated by 2007, but development towards

increased competition in this segment has progressed more slowly than in the electricity market (see the gas market fact box on page 15).

Uneven development in the electricity markets

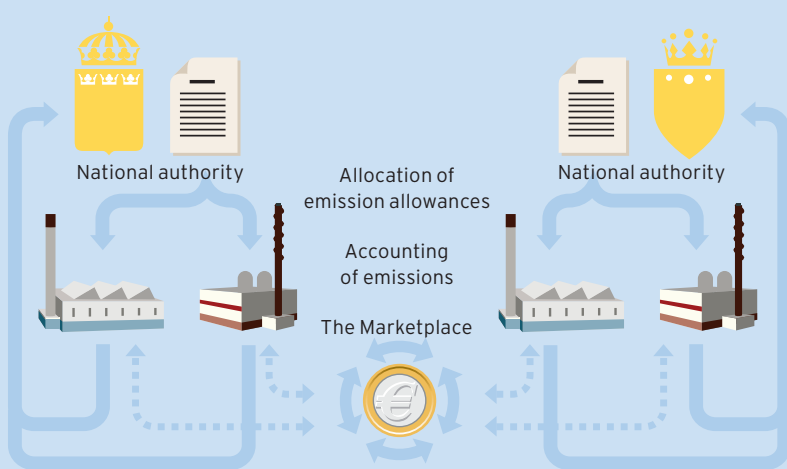
The changes have resulted in pressure to cut prices and costs, lower margins in the supply business and increased competition. Consumers now have the opportunity to freely choose their electricity suppliers and increased ability to customise price and risk profiles. Several studies, such as the Swedish Electricity and Gas Market Survey, have shown that the deregulated market in the Nordic countries is working well. Some other electricity markets in Europe have still not developed into liquid regional markets. In national markets, there is a high level of market concentration and customers have a narrow range of choice available. Price trends during the past two years have led to strong protests from customers, above all from the power-intensive industries in Europe. Against this background, the EU's anti-trust authority began a so-called Sector Inquiry into the electricity and gas markets in June 2005.

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Trading in emission allowances

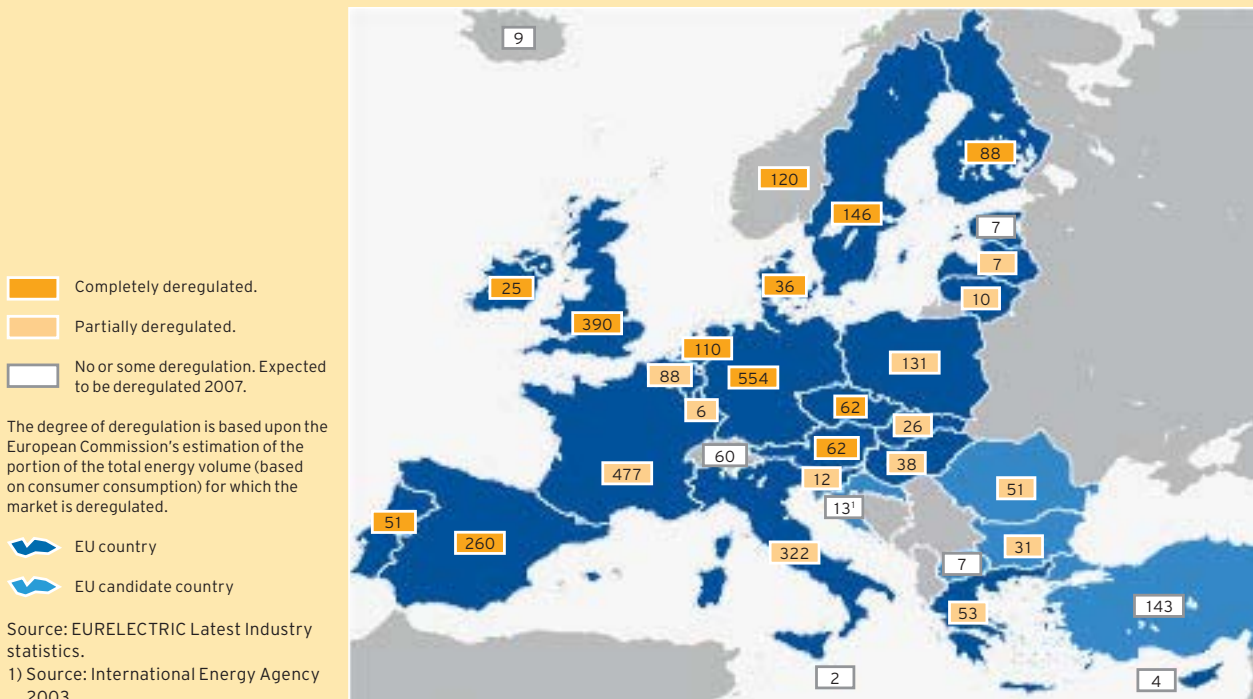
One of the most serious environmental problems of our time – the ongoing climate change – is an issue that not only dominates the European environmental discussion, but that also affects the global energy market to a large degree. According to the Kyoto Protocol, the EU mem-

The trading system for carbon dioxide allowances

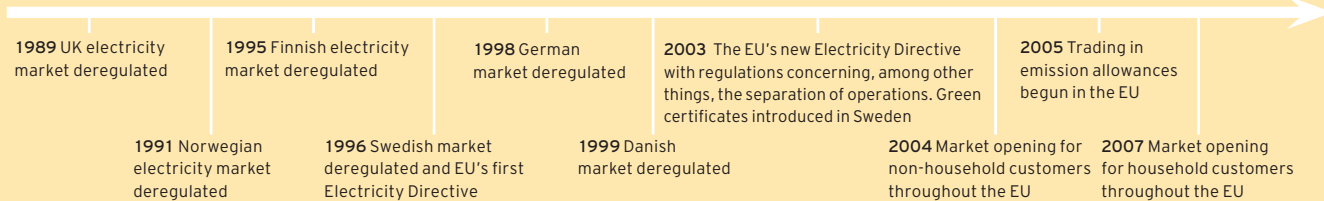


The different countries national allocation plans for emission allowances places a cap on how high emissions can be. Power plants and industrial installations then are allocated emission allowances up to the total cap. The emission allowances trading system creates opportunities for the company to prioritise the most economical method of reducing emissions. The producers can choose between implementing technical measures in order to lower emissions, purchasing additional emission allowances or refraining from producing altogether and instead selling their emission allowances on the market. This will ensure that the measures to reduce emissions are managed in the most cost-effective way.

The European electricity market (Consumption 2004, TWh)



Important events 1989–2007



ber states have committed their countries to reduce their total emissions of greenhouse gases by 8 per cent by 2012 as compared with 1990. In order to reduce the emissions that give rise to the greenhouse effect, the EU introduced a system for trading emission allowances in January 2005. The system currently covers carbon dioxide only. The first trading period runs between 2005 and 2007 and the second covers 2008–2012.

The purpose of the trading system is to contribute to attaining the EU's climate goals and living up to the commitments made under the Kyoto Protocol. This shall take place in a cost-efficient manner and in a way that is effective from a socio-economic perspective. This is achieved by capping the allocation of emission allowances to plants (with capacity >20 MW) that emit carbon dioxide. The cap limits emissions and as allowances become scarce, their market price will rise. Hence, an economic incentive is provided for increased investments in generation with lower carbon dioxide emissions. Companies will always have to balance the options of either buying emission allowances or taking

technical measures to reduce emissions, which results in choosing the most cost-effective method.

To begin with, the system only covers power plants and certain heavy industry segments. The conclusion after a year's trading in emission allowances is that the system has worked well. On the other hand, prices for emission allowances have been considerably higher than most analysts predicted, which has affected electricity prices more than expected (read more under Pricing on page 24).

Various methods for regulating network companies

As a rule, in the old monopoly structure, the entire value chain, consisting of production, transmission, distribution and supply, belonged to the same company without any obligations regarding disclosure. After deregulation, production and supply have been opened up for competition, while transmission and distribution, which are natural monopolies, have remained regulated.

Network operations are natural monopolies since it would not be economically rational from a societal point of view to introduce competition by, for example, building parallel sets of power lines. Network tariffs are therefore regulated and monitored by an independent authority. The principles that govern network regulation vary between countries and there are different regulatory models, such as returns-based regulation, cost-based regulation and incentive-based regulation. In addition, regulation can take place in two different ways: ex-ante regulation, where network tariffs (or at least a model for how tariffs are calculated) must be approved by the regulator prior to implementation, and ex-post regulation, where the network tariffs are examined by the regulator after they have been charged. The EU Commission recommends ex-ante regulation. Common to all legislation and monitoring models is that they must:

- Enable connection and use of the network for all users under non-discriminatory conditions
- Provide operators a reasonable return on invested capital

- Provide network operators the possibility and incentive to increase efficiency and reliability of supply
- Protect the customer from being abused by the monopoly

In Sweden, the regulator has developed a calculation model, the so-called network performance assessment model, to judge the fairness of the network companies' network tariffs. The model uses a fictitious network to assess network companies' performance. In principle, the calculated network performance provides, according to the model, the permitted income level. The relation between the calculated income level and actual income, the so-called charge ratio, then provides the basis for the regulator's examination of the company's network fees. The model and its application have been strongly questioned by many network companies and Vattenfall is of the opinion that the model can not be strictly applied for regulatory purpose in the manner that it has been applied to date.

In Finland, a new returns-based regulatory model was introduced in 2005.

Germany previously had voluntary industry agreements, but has now introduced ex-ante regulation. On 13 July, the new German energy industry act (EnWG) came into force. As a result, the new German network regulator, Bundesnetzagentur, could start its work. Initially, all tariff changes must be approved by the regulator, although transition to an incentive-based regulatory model is planned for 2007.

In Poland, network tariffs are regulated in accordance with an ex-ante cost plus model where tariffs must be approved prior to charging. As of 2005, capital costs are allowed to be included in the calculation of the total cost.

Projected electricity consumption

Countries/Regions	Electricity demand TWh, 2004	Projected annual growth, % p.a. 2002-2010
Cyprus and Malta	6	5.8 ²
Greece	53	4.7
Ireland	25	3.9
Iberia	311	3.6
Italy	322	3.1
Benelux	204	2.1
Other Eastern Europe ¹	162	2.0
UK	390	1.9
Austria	62	1.7
Poland	131	1.7 ³
France	477	1.6
Switzerland	60	1.4
Nordic Countries	397	0.6 ³
Germany	554	0.5 ³

Source: EURELECTRIC Latest Industry statistics.

1) Includes the Czech Republic, Estonia, Hungary, Latvia, Lithuania, the Slovak Republic and Slovenia.

2) Growth projections for Malta are estimated.

3) Vattenfall's projection.

Supply and demand in Europe's electricity markets

There are in total 240 million electricity customers in Europe, of which almost 20 per cent in Germany

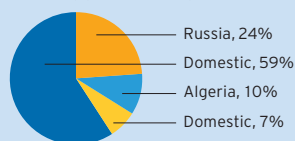
Natural gas in Europe

Natural gas is the second largest energy source in Europe and accounted for about 24 per cent of the total energy supply in 2004. The majority of the gas comes from European fields, primarily in the North Sea and the Netherlands, but a considerable portion (about 41 per cent) is imported, the majority from Russia. The most important uses for natural gas are heating, electricity generation and industrial processes.

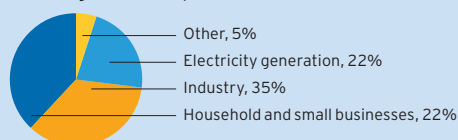
So far, the overwhelmingly dominant means of transporting gas for import is via pipeline to Europe. In recent years, however, the use of Liquefied Natural Gas (LNG) has increased dramatically, both globally and in Europe. LNG is produced in gas fields that lack a nearby market. The gas is cooled to a liquid form, then transferred to special tanker ships for transport to the importing country, where it must then be re-converted to a gaseous state and then fed into the ordinary gas network.

Swedish gas usage is relatively moderate, about 10 TWh per annum or about 2 per cent of total energy use. However, in the geographical area that has access to gas, primarily the west coast, gas accounts for about 15–20 per cent of energy use. Two major

Gas supply in Europe (2004)



Use of gas in Europe (2004)



gas projects are planned in proximity to Sweden. One involves Russian gas and a pipeline under the Baltic Sea to Germany. The other project is planned for southern Norway (Grenland and Oslo) with possible extensions to Sweden.

and about 12–13 per cent in the UK, France and Italy respectively. The total electricity consumption in Europe (EU 25 plus Norway and Switzerland) amounted to 3,150 TWh in 2004. Annual consumption is expected to increase by an average of 1.7 per cent until 2010, primarily in southern Europe and central eastern Europe.

There is still a certain level of surplus capacity in Europe, but this is being reduced as older power plants are taken out of operation and through increased consumption. In the Nordic countries increase in electricity consumption is projected to remain low. During a “normal year” i.e. when the so-called hydrological balance is normal, supply and demand is in balance. Upgrades of existing Swedish nuclear power plants and as from 2009 a fifth nuclear reactor in Finland will increase capacity. In addition, capacity in the area of renewable energy is expected to increase in coming years, in both Sweden and Norway.

Growth in the German electricity market is also projected to be low. Wind power generation in Germany has increased significantly during recent years due to extensive subsidies. A large portion of fossil-based generation will need to be replaced or renewed in coming years.

The Polish electricity market is growing faster than the Nordic and German markets. Deregulation, however, has not advanced particularly fast and Poland will therefore need to up speed its deregulation process and upgrade power plants in accordance with stricter environmental regulations in coming years. There is also a great need to replace aging power plants over the next ten years.

The Dutch, Belgian and French governments have taken the initiative to create a regional market in the Benelux countries. The reasons for this include optimising transmission capacity between the countries and increasing competition in otherwise strongly concentrated national markets.

Growing market for district heating

Environmentally-friendly heating alternatives are becoming increasingly important in the European energy market. This has led to an increase in district heating in recent years. It is primarily the Nordic countries and former Eastern Europe that have large markets for district heating. The four largest markets in Europe are Poland (105 TWh), Germany (90 TWh), Sweden (52 TWh) and the Czech Republic (41 TWh), which together represent more than half of the European district heating market.

The advantages of district heating are that it enables more efficient use of fuel and the use of fuel that has no other alternative use, such as logging remnants and waste, which has resulted in a successive decrease in carbon dioxide emissions. A large portion of district heating comes from CHP plants that also generate electricity. The EU believes that a considerable increase in combined heat and power will occur between now and 2010. The primary alternative to district heating is natural gas, mainly in Germany. The trend is for gas and district heating to replace oil. District heating plays a large role in reaching environmental goals in Europe and there is a belief that district heating will be prioritised in the future as well.

M & A ACTIVITIES PICKING UP MOMENTUM

After a couple of years' of inactivity, the trend was broken, with major structural transactions once again seen in the European energy market in 2005. During the year, a range of major transactions were carried out or initiated. In addition, Europe's largest electric utility, France's EDF, was floated in 2005.

When, in the beginning of the 1990s, the national power utilities were exposed to competition, profit margins dropped. This triggered a wave of strategic acquisitions across national boundaries. After deregulation and privatisation in England and Wales in the beginning of the 1990s, the privatised companies were acquired by primarily American energy companies. When these companies left Europe, the English utilities were acquired by German E.ON and RWE and by French EDF. Several southern European power utilities ventured in Latin American growth. Some electric utilities also broadened their operations to new product areas such as telecommunications.

Back to core business

This, primarily debt financed, expansion led to dramatically weakened balance sheets, rating downgrades and lessened confidence from the capital mar-

kets. Several utilities also failed to deliver promised synergies. In 2002/2003, the major utilities changed their strategies. They stopped growth investments and instead concentrated on consolidation and the integration of acquired companies as well as on reducing debt and divesting non core assets. This "back-to-basics" focus has been successful and the financial position of these utilities have improved.

Electricity and gas utilities have worked towards upstream integration in order to back up trading activities with physical assets. In some countries, politicians have tended to support development that has favoured national champions, i. e. large, integrated utilities, rather than creating a market with high competition and less market concentration.

Resumed M&A and privatisation activity

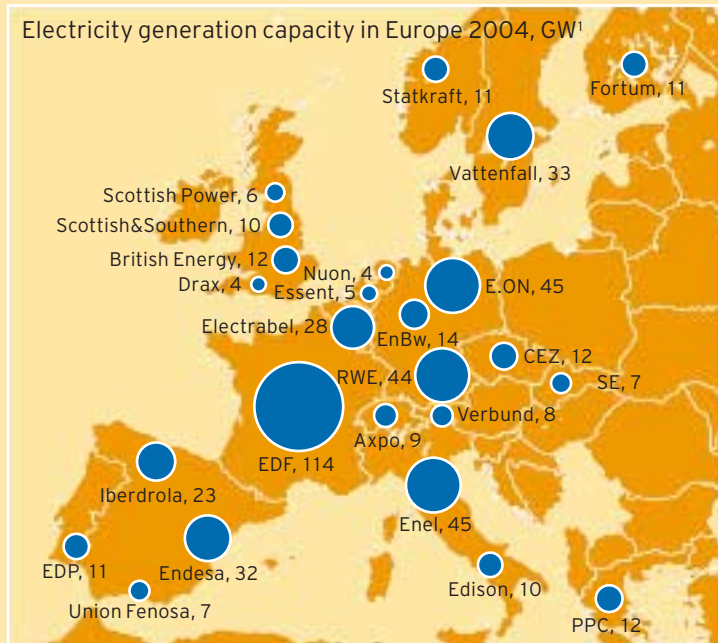
Overall, utilities reported stronger operating profits

Major M&A transactions in the European energy market in 2005

Company	Acquisition target	Amount
Suez	49.9% of Belgian Electrabel. 100% holding after acquisition	EUR 11.2 billion
EDF and AEM	80% of Italian Edison	EDF EUR 7 billion AEM EUR 1.2 billion
Dong	Danish Elsam, E2, Nesa, Copenhagen Energy	not disclosed
Vattenfall	Elsam 35.3%	SEK 10.3 billion
Enel	66% of Slovakian SE	EUR 840 million
Gas Natural and Iberdrola	Bid for Spanish Endesa ¹	EUR 22.5 billion (not completed)
EDF	Motor Columbus 17.3%	not disclosed
EnBW	16.8% of EVN. 30% holding after acquisition	not disclosed
Fortum	E.ON Finland, 99.8%	EUR 744 million

Company	Divestments	Amount
RWE	British and American water utilities; Thames Water and American Water	EUR 13–16 billion (sales not completed)
E.ON	Real estate company Viterra	EUR 7 billion
Enel	Telecom operator Wind	EUR 12.4 billion
Endesa	Telecom operator Auna 32.7%	EUR 2.1 billion
Union Fenosa	Telecom operator Auna 18.7%	EUR 1.2 billion
Scottish Power	Pacificorp (USA)	EUR 4 billion
Fortum	Oil company Neste oil (85% spin-off)	EUR 1.4 (for 15% sold)
EDF	Edenor (Argentina)	not disclosed

1) On 21 February 2006 German E.ON launched a counter bid for Endesa of EUR 29.1 billion.



1) The circles represent each player's total European generation capacity and have been placed in each player's 'home market'.

Vattenfall's market position

	Sweden	Finland	Germany	Poland
Electricity Generation	1 ⁴	1 ⁴	3	7 ¹
Electricity trading	Top 3 ⁴	Top 3 ⁴	Top 3	–
Distribution	2	2	4	6 ²
Supply	1	3	3	6 ²
District heating	4 ⁴	4 ⁴	1	1 ³

1) Market position number four if only privatised companies are included.
 2) Market position number one if only privatised companies are included.
 3) Only heat generation.
 4) In the Nordic countries.

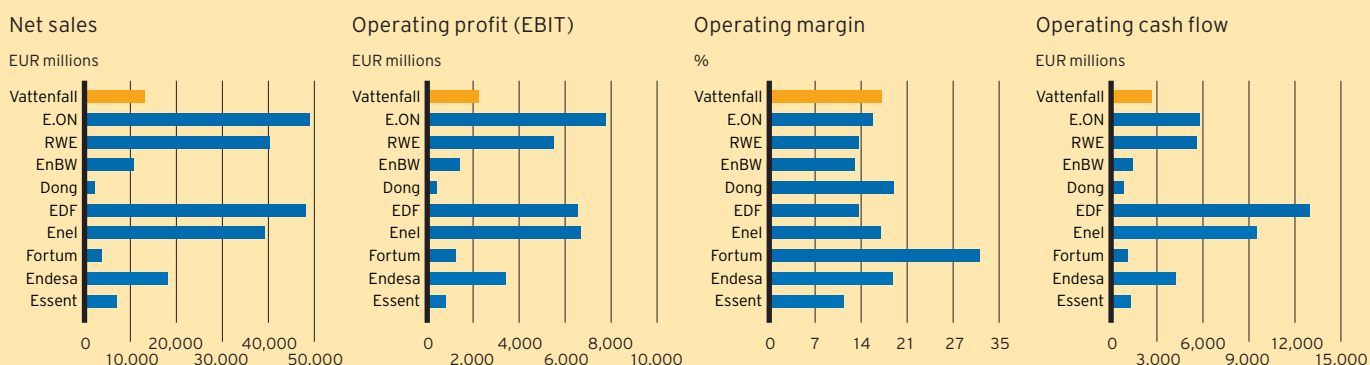
from their core energy operations during the year. Dramatically increased wholesale prices – in addition to cost-reductions and divestments – have improved cash flow and credit metrics. Pressure from shareholders to either raise dividends or to create further value through profitability and growth through acquisitions has increased.

While at the same time that utilities have streamlined their operations by divesting non-core businesses, several utilities began once again to act as buyers. Several M&A transactions have taken place or were initiated. French Suez purchased the outstanding minority shares in Belgian Electrabel, EDF finally managed to acquire 50 per cent of Italian Edison, Dong and Vattenfall bought Danish power assets, Enel acquired a majority holding in Slovakian Slovenske Elektrarne and in Spain, Gas Natural initiated a hostile takeover of Endesa in combination with the sale of major assets to Iberdrola. In 2005, the long-discussed and anticipated public offerings of the French

state-owned Gaz de France (GDF) and Electricité de France (EDF) took place. The French state now holds about 80 per cent of the shares in GDF and 85 per cent of EDF. The market introduction of EDF was the largest initial public offering in Europe in 2005. Vattenfall is now the only major non-listed power utility in the EU.

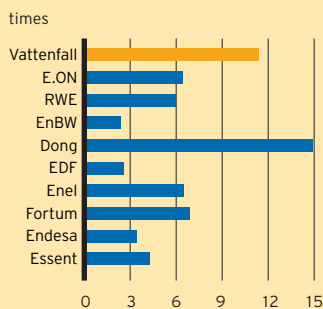
The expected privatisation wave in Eastern Europe after the EU enlargement has been delayed, due in part to uncertainty regarding regulations, investment requirements and the ability to rationalise operations through staff cutbacks. Czech CEZ, however, has expanded considerably and has clear ambitions to grow in the region. In the Netherlands, the government has renewed its bill regarding the demerger of the distribution network from the existing players. The timetable for this has been moved from 2007 to 2008. While this structural shift is gaining momentum, the EU has announced increased supervision with an eye towards limiting market concentration.

Comparison of certain European energy utilities (As of 30 September 2005 unless otherwise stated)

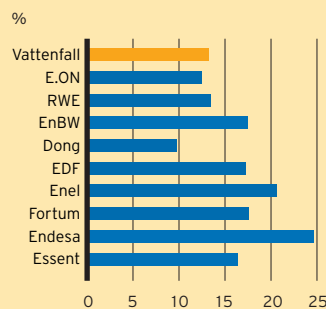


	Vattenfall	E.ON	RWE	EnBW	Dong
Country	Sweden	Germany	Germany	Germany	Denmark
Listing	Not listed 100% state owned	Listed	Listed	Listed (EDF owns 45.01%)	Not listed 100% state owned
Electricity sales 2004, TWh	186 (207 incl. deliveries to minority owners)	404 (Of which Europe 356)	296	100	-
Number of customers, millions	Electricity: 6 (incl. network)	Electricity: 22 Gas: 8	Electricity: 21 Gas: 10 Water: 15	Electricity: 5 Gas: 0.4	Gas: 0.1
Primary products	Electricity, heat	Electricity, gas	Electricity, gas, water	Electricity, gas, water	Gas, oil
Primary markets	Nordic Countries, Germany, Poland	Central Europe, UK, Nordic Countries, Russia	Germany, UK, Central and Eastern Europe	Germany, Central and Eastern Europe	Denmark, (Sweden, Germany, Netherlands)
Strategies	<p>Five strategic ambitions:</p> <ul style="list-style-type: none"> • Profitable growth in the neighbourhood area through both M&A and new production facilities • To become the Benchmark for the industry • To become Number One for the Customer • To become Number One for the Environment • To be the employer of choice 	<ul style="list-style-type: none"> • To Integrate and strengthen its electricity and gas operations • Reinforce its gas supply position through own gas fields and potentially LNG • Expansion in Russia, Italy and Spain 	<ul style="list-style-type: none"> • Focus on electricity and gas in its four primary regions • Divest water operations in UK and USA 	<ul style="list-style-type: none"> • Be number three in German energy market • Develop positions in Central and Eastern Europe • Develop its strategic alliance with EDF 	<ul style="list-style-type: none"> • Secure its gas supply • Integrate gas and electricity operations • International growth (Sweden, Germany, Netherlands)

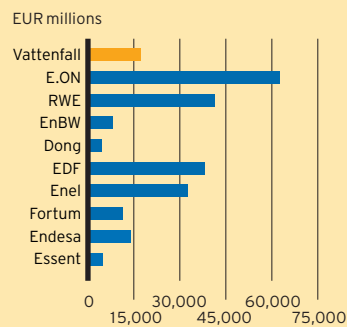
Net interest cover



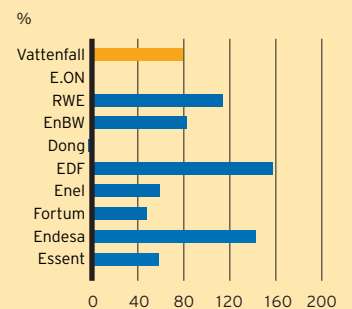
EBIT/Capital employed



Capital employed



Debt/equity ratio, net



EDF	Enel	Fortum	Endesa	Essent
France	Italy	Finland	Spain	Netherlands
Listed 2005 (French state owns 85%)	Listed (Italian state owns 32.2%)	Listed (Finnish state owns 51.5%)	Listed	Not listed
610	158 (258 incl. resellers)	62	181 (of which Europe 129)	49
Electricity: 42 (of which Europe 36)	Electricity: 30 Gas: 2 Telecom: 1.4	Electricity: 1.1	Electricity: 22 (of which Europe 21) Gas: 0.4	Electricity: 2.5 Gas: 1.9
Electricity	Electricity, gas	Electricity, heat	Electricity, gas, water	Electricity, gas, heat
France, UK, Germany, Italy, Eastern Europe	Italy, (Spain, France, Slovakia, Bulgaria, Rumania)	Nordic countries, Baltic States, Russia	Spain, Portugal, Latin America, Italy, France	Netherlands, Germany, Belgium
<ul style="list-style-type: none"> Stabilise ownership structure in its foreign holdings Divest non-core businesses Improve productivity Invest in gas assets in order to be able to offer customers both electricity and gas 	<ul style="list-style-type: none"> Focus on core energy business (water and telecom divested) Expansion in Eastern Europe Convert all oil-fired power plants to gas or coal 	<ul style="list-style-type: none"> Expand in Nordic Countries, Baltic States, Poland and Russia Oil and shipping operations separated 2005 	<ul style="list-style-type: none"> Consolidate its position in Spain and Latin America Develop activities in France and Italy Telecom operations have been divested 	<ul style="list-style-type: none"> Strengthen its core operations Selective growth in the neighbourhood area Divest non-core operations

Rolling 12-month values as of 30 September 2005 for all companies except EDF, Endesa and Essent, which are as of 30 June 2005.

Sources:

Diagram values: Barclay's Capital.
Electricity sales, Number of customers, Primary products, Primary markets, Strategies: Vattenfall research, annual reports, interim reports and company homepages.

Definitions:

Total Capital = interest-bearing liabilities + equity incl. minority interests. Operating cash flow = FFO +/- changes in working capital.



TO BECOME THE BENCHMARK FOR THE INDUSTRY

"FORSMARK IS A WORLD LEADER, NO MATTER HOW YOU LOOK AT IT"

Deep down in the reactor pool the heart of Forsmark is concealed: the reactor. Here, every second, 1,600 litres of water are boiled into steam for further transport to the turbine. After some twenty years in use, all the trends are positive for Forsmark – a model facility in the nuclear power industry.

In 2005, availability for the three reactors was almost 93 per cent on average and electricity generation almost reached 25 TWh. That corresponds to more than a sixth of the electricity that Sweden needs.

"We are among the world leaders, both with regard to cost per produced unit and low environmental impact," says Claes-Göran Runermark, Deputy Managing Director of Forsmark.

"Before Forsmark was built, we conducted a benchmarking project and saw how others, at the best nuclear reactors in world, worked."

That paid off. Ever since the middle of the 1980s, Forsmark's three reactors have delivered far more than was predicted. And now, Vattenfall is investing SEK 6 billion to hone the reactors even further. The facilities are to be modernised, both with regard to technology



and safety. The turbines in the different units, for example, were replaced between 2004 and 2006. An increase in generation capacity is planned to be carried out 2008–2010, assuming the Swedish government approves the necessary permit. All in all, these measures can result in increased generation capacity corresponding to more than 4 TWh.

Forsmark is also a leader in environmental issues: the facility was the first in the world, for example, to supply electricity with a certified environmental declaration and is also certified in accordance with ISO 14001.

One key component of the facility's success is, of course, the staff. The level of expertise is very high among the 800 people working here and many of them have long experience and are highly educated.

Eva Petterson, for example, began as a station technician in 1988. Today, she is one of the country's few female reactor operators. She is responsible for supervising the operation and safety of the reactor facility.

"It's a very special job, but very enjoyable too," says Eva.

Benchmark for the industry:

The Vattenfall Group's Key Performance Indicators

In accordance with our ambition to serve as a benchmark for our industry, so-called Key Performance Indicators have been defined for each business unit and, as of 2006, these will be followed up monthly at Group level.

Generation

Cost per MW, availability and average sales price

Electricity Networks

Number of disruptions, operating costs and maintenance investments

Sales

Customer satisfaction index, number of customers, cost-to-serve per customer and margin per customer segment

Heat

Cost per MW, availability and average sales price

LARGE PRICE DIFFERENCES BETWEEN REGIONS BUT HIGHER CORRELATION

In 2005, European electricity wholesale prices rose sharply, mainly due to increased fuel costs and the new trading system for emission allowances. But during the year prices in Europe also exhibited higher correlation.

Electricity wholesale prices are still dependent on local production conditions, although price correlations between countries have increased.

Previously, water supply was the factor with the greatest impact on price development in the Nordic countries, as hydro power represents a very large part of power generation. Despite good water supply, in 2005 we saw Nordic electricity prices climb in unison with prices in Central Europe as fossil-based power in Denmark and Finland from time to time determines prices in the Nordic market. International trade in coal, oil and gas has contributed to increased covariance, primarily in countries with similar production. Actual price levels still vary between different regions, but prices in the European electricity market are levelling out to an increasing extent. If cross-border

transmission capacities between countries are further improved, this trend will continue.

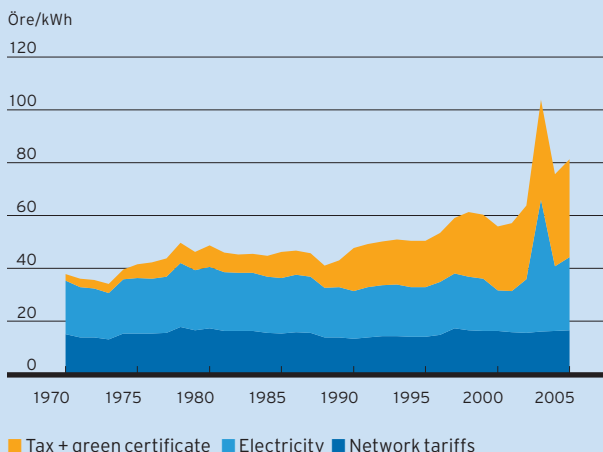
Supply and demand determine electricity prices

In a well functioning market, it is market equilibrium, i.e. the point where supply meets demand, that determines the wholesale price. Production facilities are taken into operation in accordance with the 'merit order dispatch' system, which means that the plant with the lowest variable costs is the first to be taken into operation. Supply and demand therefore determine which type of production is used.

Competition in the electricity market leads to pricing based on this wholesale price, which leads to:

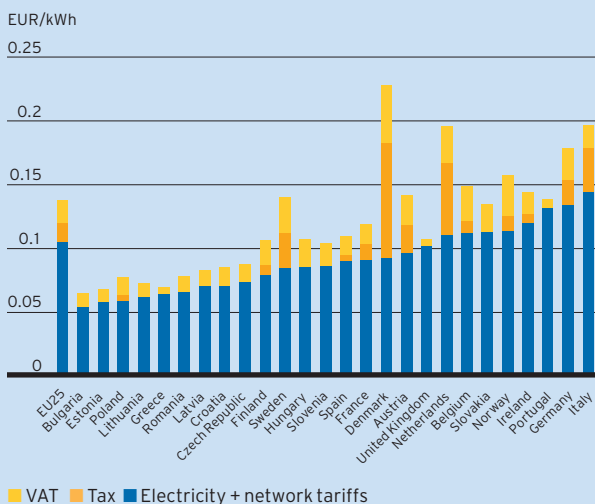
- *Effective resource allocation.* The most cost efficient

Electricity prices and taxes in Sweden



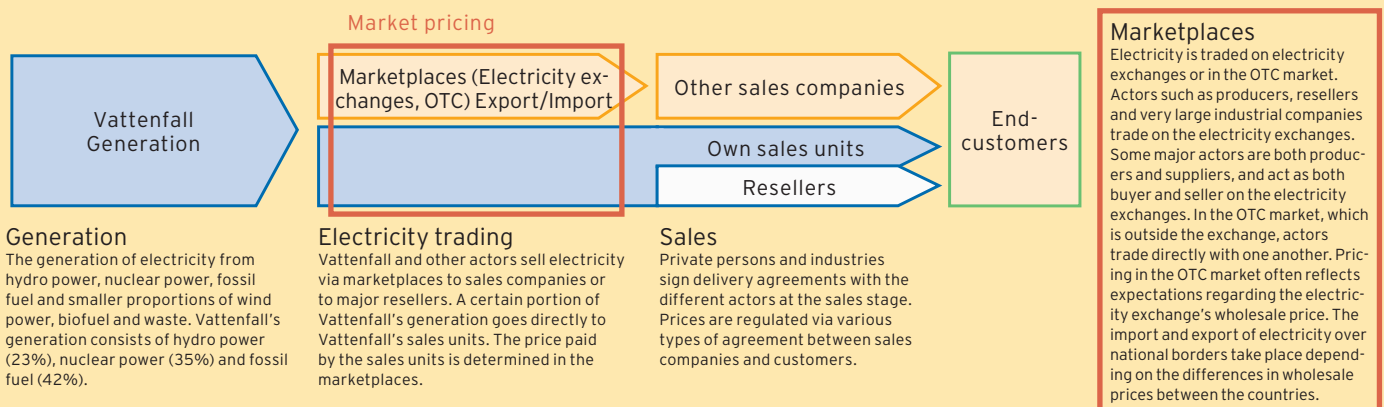
20 000 kWh/year, variable prices, in 1990 monetary value
Source: SCB, Svensk Energi

Household electricity prices in Europe

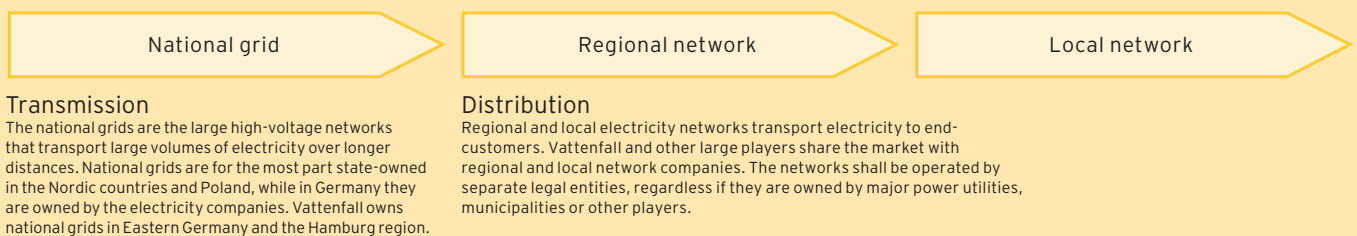


Household customers 3,500 kWh/year, January 2005
Source: Eurostat

Vattenfall and the electricity value chain



Distribution chain



power sources are taken into operation first and more expensive power sources only when demand requires it. Marginal pricing ensures that every electricity generation plant covers – at least – its variable generation costs.

- *Clear signals for future investments.* As the price is set for the last generation utilised, generators receive a clear signal as to whether future investments are economically viable.
- *Increased transparency.* A prerequisite for a well-functioning market is that all bids are anonymous. If this was not the case, an electricity producer with low variable costs could “guess” other producers’ costs, risking market manipulation.
- *All players get the same price.* If all electricity sellers are paid the same price in a transparent system, the electricity sellers compete on equal terms, regardless how the electricity is generated. This prevents electricity sellers, which have access to power sources with low variable cost, from dumping electricity prices. Otherwise this could force sellers without own electricity production assets to abandon the market.
- *Fair pricing for consumers.* As the variable costs vary between different types of production, it would be difficult to determine which customers should get a “cheap” price and which customers should get an

“expensive” price, as the low cost production does not suffice to meet demand.

In the Nordic countries and in Germany, extensive trading takes place on the Nord Pool and EEX electricity exchanges, which set market prices daily. Forward trading also takes place on the electricity exchanges and reflects market expectations for future electricity wholesale prices. In the forward market, the price is also set as a function of supply and demand, but the price applies only to the individual contract. Good liquidity in the forward market is crucial since wholesale electricity prices are largely based on the forward prices. Nord Pool’s liquidity is good. On EEX traded volumes and liquidity have increased, but are still not on a par with Nord Pool. In Germany, a large part of the volumes are traded outside the EEX, on the so-called OTC (Over The Counter) market. In practice, however, there is no price difference between electricity exchange prices and OTC prices for long-term standard contracts.

Network business needs stable regulatory framework

Network business, i.e. the transport of electricity in the electricity networks, is regulated and supervised by special authorities. From the customer perspective

it is important that the regulatory models provide stable conditions. Returns on capital must be sufficient to provide incentive for maintenance and new investments. (Different regulatory models are described on page 14.)

Emission allowances affect electricity prices

Trading in emission allowances has functioned well, but prices have been higher than most analysts expected. The average price in 2005 was 16 EUR/tonne with a peak of about 29 EUR/tonne in July. High oil and gas prices during the year led to increased use of coal in electricity generation. This increased demand for – and the price of – emission

allowances, which in turn led to higher electricity prices.

As there is a market price for emission allowances (regardless if the emission allowances have been purchased or received free of charge), electricity producers must include this as an opportunity cost. The emission allowance is either used to generate electricity, which creates emissions, or sold in the market. As more players become involved in the selling of emission allowances, prices will be moderated and eventually stabilise. However, uncertainty about which allocation principles will apply to the next trading period, 2008–2012, is great, and it is therefore difficult to make any reliable price forecasts.

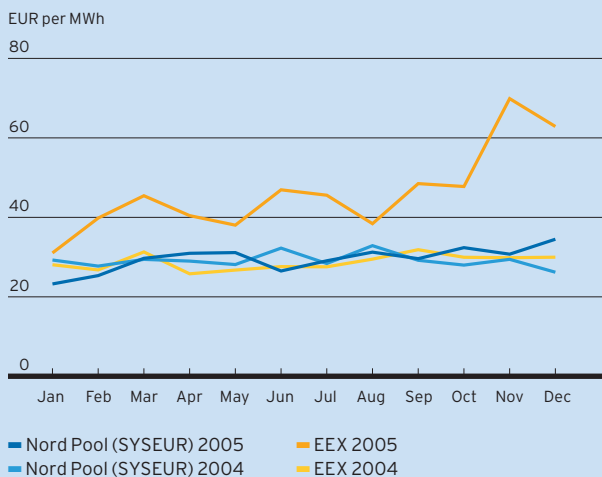
Electricity price development

Spot price development

In 2005, average base-load spot prices on the Nordic electricity exchange, Nord Pool, were slightly higher than in 2004, EUR 29.3 per MWh, compared with EUR 28.9 per MWh.

On the EEX, the German electricity exchange, average spot prices were about 61 per cent higher than in 2004, EUR 46.0 per MWh compared with EUR 28.5 per MWh. While in 2004, the Nordic and German spot prices were on roughly the same average level, German spot prices rose sharply in 2005 and hence were on a considerably higher level than the Nordic prices.

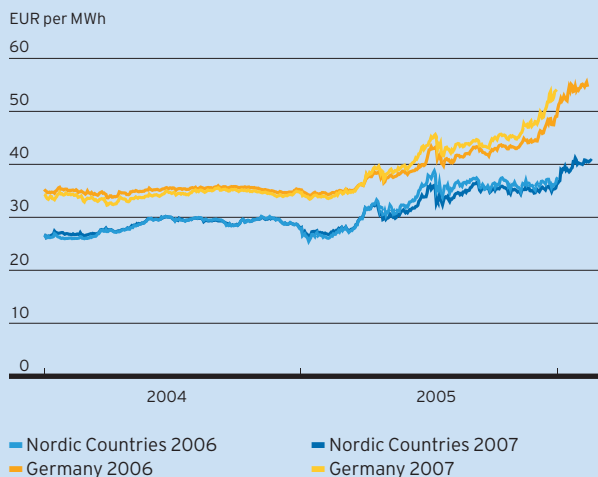
In Poland the average spot prices on POLPX, the Polish electricity exchange, were somewhat higher in 2005 than in 2004, PLN 114 per MWh compared with PLN 110 per MWh.



Forward price development

In the Nordic countries, forward contract prices (base-load) for 2006 and 2007 closed at EUR 37.4 per MWh and EUR 35.3 per MWh respectively, compared with average closing prices in 2004 of slightly more than EUR 28 per MWh. Corresponding forward contracts in Germany closed at EUR 53.6 per MWh and EUR 48.9 per MWh respectively, compared with average closing prices in 2004 of EUR 34.1 per MWh and EUR 34.9 per MWh respectively. The high electricity wholesale prices of 2005 were chiefly due to high fuel prices and the high prices of emission allowances for carbon dioxide.

Correlation between the Nordic countries and Germany is high but the German price levels are significantly higher. In Poland, the forward market is still at the development stage with low turnover and liquidity.



Subsidies for electricity based on renewable energy

In order to increase the proportion of renewable energy, many European countries have introduced financial subsidies that favour electricity generation based on, for example, wind power and other renewable energy sources.

With the support of the German EEG law (Erneubare-Energien-Gesetz), the German government has decided to increase the proportion of renewable energy in electricity generation to 20 per cent by 2020. Electricity from renewable energy sources is subsidised and is therefore outside the market and its marginal pricing. The EEG regulations

stipulate that all renewable energy shall be prioritised in the transmission system.

In Sweden, a green certificate system was introduced in 2003. Generators receive one green certificate for every MWh of electricity produced using renewable energy sources and delivered to the network. Electricity consumers must buy a certain number of green certificates. This creates the necessary business conditions for this type of production and enables investments.

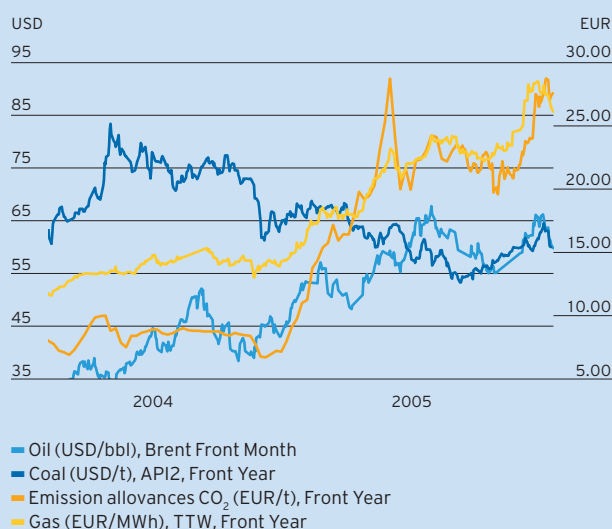
In Sweden the goal is to produce 10 TWh of electricity from renewable energy sources by 2010. The Swedish government has proposed that the system be extended to 2030.

As of this year, Poland introduced green certificates to be traded via the electricity exchange or bilaterally. The electricity producers are obliged to ensure that at least 3.1 per cent of their sales to end-customers are based on renewable energy. This proportion will be increased gradually until 2010.

Coal, oil, gas and emission allowance price trends

In 2005 electricity wholesale prices rose sharply in Europe during 2005, primarily due to dry weather in Southern Europe and record high oil and gas prices which have led to increased use of coal in electricity generation. This drove up the price of emission allowances for carbon dioxide and thus electricity wholesale prices.

In 2005, the price of emission allowances was initially below EUR 10 per tonne but has since risen dramatically to a high in July of EUR 29 per tonne. On average for the year, the price of emission allowances was EUR 16 per tonne.



Heat prices and price trends

In Sweden, district heating prices have risen in recent years from low levels to new levels, where they have stabilised. Financially competitive alternatives, such as geothermal heat, are putting pressure on prices. The price trend for district heating in Sweden will not be affected by so-called green tax balancing as environmental performance has been considerably improved in recent years. District heating is well adapted and judged to remain a competitive alternative in the regional European energy markets due, among other things, to the fact that environmentally-profiled economic means of control and customer preferences will favour such heating alternatives.

INCREASED INVESTMENTS IN RENEWABLE ENERGY SOURCES

Vattenfall's ambition is to have a leading role in renewable electricity and heat production. In 2005, measures included the decision to build one of Europe's largest wind power farms. Vattenfall's customer offering also includes energy services and advice to contribute to more efficient energy use.

Renewable energy sources will play an increasingly important role in the future. Increasing fossil fuel prices and various subsidies for renewable energy sources will provide increasingly favourable business conditions for this development.

Of current world energy consumption, a little over 13 per cent is derived from renewable sources and about 7 per cent from nuclear power. The remaining roughly 80 per cent comes from fossil fuel.

Of the renewable energy sources, biofuel is by far the most common, hydropower comes second, while at this time the other sources represent a very small proportion of energy consumption. The EU's goal is for 12 per cent of all energy used in 2010 to stem from renewable energy sources, compared with 6 per cent in 1997. As for electricity generation, the goal is 22.1 per cent compared with 13.9 per cent in 1997.

Vattenfall drives development

Vattenfall's ambition is to have a leading role in renewable electricity and heat generation where the ecological, technical and commercial prerequisites are present – primarily within hydro power, biofuel-fired plants and wind power. Vattenfall, by standing at the forefront and driving development forward within the framework of its commercial activities, can contribute to ecologically and economically sustainable development. At the annual general meeting in 2005 an addition was made to Vattenfall's articles of association stating that "the Company shall, within the framework of businesslike operations, be the leading company in the transition to an ecologically and economically sustainable Swedish energy supply". The motivation for the change states that the company, under certain conditions, ought to be able to provide 5 TWh of new electricity generation from renewable energy from the 2002 level by 2010. Vattenfall's investments in renewable energy generation in the Nordic Countries since 2002 is shown in the table to the left.

The total proportion of renewable energy in Vattenfall's heat generation is currently 19.4 per cent (18.3) while the figure for electricity generation is 23.9 per cent (20.4). The proportion of electricity generated by the Group using renewable energy sources, excluding hydro power, is 0.3 per cent (0.4).

Returns on Vattenfall's investments in renewable generation in the Nordic Countries 2005

	Wind power	Hydro power	Heat	Total
Investments, SEK millions	18.3	65.9	512.3	596.5
Tangible non-current assets, SEK millions	379.9	277.6	3,754.9	4,412.4
Return on tangible non-current assets, %	1.0	25.3	7.6	8.2

Vattenfall's renewable generation in the Nordic Countries (GWh)

	2002	2003	2004	2005
Generated electricity				
Hydro power	35,600	28,100	33,600	39,800
–of which small-scale hydro power ¹	218.6	160.8	225.8	189.7
Wind power ¹	50.4	55.0	58.9	54.4
Biofuel ¹	525.0	503.0	497.0	547.0
Total electricity	36,175	28,658	34,156	40,401
Generated heat				
Biofuel ¹	4,020	3,844	4,506	4,577
Waste ²	700	700	700	900
Total heat	4,720	4,544	5,206	5,477
Total renewable generation	40,895	33,202	39,362	45,878

1) Sweden and Finland

2) Sweden

Renewable energy within Vattenfall

Hydro power

In the Nordic countries, Vattenfall has about one hundred hydro power plants, about half of which are small-scale units. In an average year, these hydro power plants generate about 33 TWh. In Germany, the Group owns 14 hydro power plants, 8 of which are pumped storage power plants.

Renewable fuel

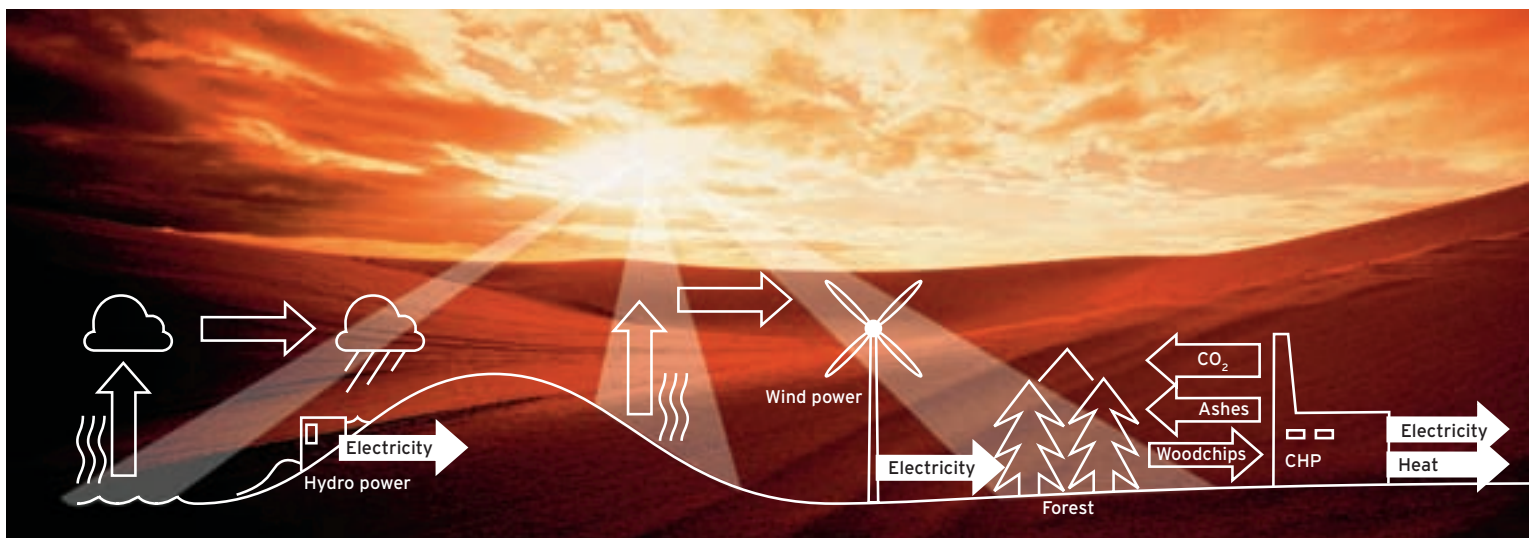
Vattenfall operates almost 90 plants that use renewable fuel and is one of the world's largest buyers and users of biofuel for energy generation. In Vattenfall's Nordic heat and combined heating and

power production, biofuel comprises about 55 per cent of the energy supply.

Wind power

Vattenfall has 49 wind power turbines in the Nordic countries, which together generate approximately 54.4 GWh. In Germany, Vattenfall has 3 wind power turbines, which generate 4 GWh. With the investment in the offshore wind power park at Lillgrund and the acquisition of Danish wind power turbines, Vattenfall's generation capacity will multiply many times over and we will be one of Europe's largest wind power producers.





Renewable energy sources make use of solar radiation falling on the Earth and do not consume finite natural resources.

Sweden's largest wind power farm

In 2005, Vattenfall made the decision to build a wind power park at Lillgrund. 48 wind turbines are planned, seven kilometres from the coast of Skåne, just south-east of Öresund Bridge. Lillgrund represents the largest investment in wind power in Sweden and one of the largest in Europe. The park will have a maximum capacity of 110 MW, corresponding to an electricity output of slightly more than 0.3 TWh. These facilities are estimated to be in operation in 2007.

Vattenfall has also acquired the rights to develop the Swedish part of Kriegers Flak, an area in the southern part of the Baltic Sea, where there is the opportunity to build one of the world's largest wind power farms with a total of 100–150 wind turbines providing a generation capacity of about 1.6 TWh per annum. This project is currently under appraisal.

In 2006, we expect to be able to incorporate more than 300 MW of wind power within the scope of our Danish acquisitions.

Maintaining existing facilities

In addition to building new power plants we also continually develop our existing facilities. As an example, the maintenance programme currently underway at our Swedish hydro power plants will

ensure continued reliability and increased capacity over the coming years.

With great dedication, Vattenfall has worked with bio energy for 30 years and has developed technologies, installations and different types of biofuel. In Hamburg and Uppsala, we have recently built ultra-modern waste incinerators that convert waste into energy. In Germany and Warsaw, we are developing combined combustion methods where different bio-fuels are mixed with coal.

As well as pursuing the commercial development of wind power, hydro power and biofuel, Vattenfall also actively participates in national and European research projects in future production technologies, such as wave power, fuel cells, black liquor gasification, geothermal power and solar power.

Helping private customers choose the right agreement

Vattenfall's ambition is to be the power company that sets the standard for customers. Setting the standard has two aspects. Vattenfall helps customers to:

- choose the right type of electricity agreement
- reduce electricity consumption

In the Nordic countries, Vattenfall encourages private

electricity customers to actively choose which of the three types of contracts – fixed price contract, variable price contract or the contract until further notice – best suits their needs and risk profile. Vattenfall's role here is to clearly describe the different types of contracts and their characteristics for customers.

As for helping customers reduce their electricity consumption, this is achieved in part with concrete advice on how to reduce electricity consumption and in part by adapting our pricing so as not to disfavour customers who reduce their consumption.

Previously, higher annual consumption led to a lower price per kWh than lower annual consumption. For customers that reduced their electricity consumption, this could entail an increased price per kWh. In order to avoid this effect, during the spring of 2005 a new pricing model was introduced so that customers with a lower annual consumption pay the same unit price as larger consumers.

Publications advise on optimisation

Vattenfall's advice on how to reduce electricity consumption is available on the company's website and in printed form. These publications describe how much electricity different household appliances consume and how customers can use simple means to reduce household electricity consumption. Naturally, we describe how heating a home affects electricity consumption and how customers can influence their overall electricity consumption.

Vattenfall's approach in providing this advice to customers is to view electricity as a product which in many cases can simplify daily tasks and improve the quality of life for individuals, but which can also be used in an economic manner.

Tailored solutions for major customers

Vattenfall wants to contribute to strengthening its customers' competitive edge by tailoring the solutions we offer within electricity and energy and process optimisation. As basic industries operate in a global and very competitive market, it is important for Vattenfall, in a professional manner, to be able to

help strengthen these customers' competitive edge, so that they can continue to develop strongly in the geographic areas where Vattenfall operates.

Vattenfall collaborates with customers in formulating suitable strategies and risk policies as regards electricity agreements. The company also offers market analysis, consulting services and active electricity contract portfolio management to major customers.

The right combination of long and short-term delivery agreements provides the customer with predictable energy costs on market terms. Market pricing favours customers who have the opportunity to reduce their consumption when the price is high, such as during peak load periods or capacity peaks. This contributes to effective use of the power system.

Energy analyses for industry

Vattenfall successfully collaborates with major industrial customers on projects to reduce energy consumption and optimise customers' manufacturing processes. We have, for example, helped customers introduce new energy management systems within the framework of the Swedish state's programme for energy optimisation. Vattenfall also conducts energy analyses, wherein we identify measures that lead to reduced energy consumption or improved energy use. In several cases, Vattenfall has taken matters a step further and assumed full responsibility for financing and implementing the optimisation measures identified in an energy analysis: project planning, technical equipment procurement, installation and operation.

Reduced carbon dioxide emissions for German customers

Vattenfall works in a similar manner in Germany. For example, in 2000 we signed a 12-year energy optimisation agreement with a hospital in Berlin. So far the project has resulted in cost-savings in excess of 28 per cent and a reduction in carbon dioxide emissions of 26 per cent.

In 2005, an energy optimisation project was conducted with a large furniture chain with resultant cost-savings of almost 10 per cent.

ENERGY ON FUTURE GENERATIONS' TERMS

Vattenfall's operations are based on long-term environmental considerations. As far as possible, we try to meet today's energy needs without risking future generations' opportunities to meet their needs. With goal-oriented work methods, Vattenfall introduces solutions that contribute to sustainable societal development.

Within the energy sector, an investment cycle usually lasts about 30 to 40 years. With goal-oriented and long-term R&D work, Vattenfall can create greater freedom of choice for both our customers and society at large.

Our responsibility

Vattenfall takes responsibility for and contributes to developing and providing energy solutions suited to sustainable societal development. However, it is not enough to only consider the environmental consequences of an individual energy solution. An energy system must be sustainable not only from an environmental perspective but also from social and economic perspectives.

In our operations, this is largely about a number of gradual improvements to increase efficiency and reduce environmental impact. We must always begin with the actual circumstances and compare all aspects of the different courses of action.

Vattenfall's contribution to sustainable development

Vattenfall works intensively with a number of different solutions such as renewable energy sources and investments in new and innovative technologies – the carbon dioxide-free power plant, for example. Investments in existing plants that do not cause any carbon dioxide emissions, such as hydro power and nuclear power, are important measures, as is reducing the emissions of fossil-fired power plants. The company's growth creates the requisites to participate in and influence development. We are pushing for the development of a global trading system for carbon

dioxide, which will avoid the distorted competition that a regional trading system creates. We also want to create better conditions for our customers to be able to use our products – electricity and heat – in an effective manner. Vattenfall shall stand for innovation in the European energy sector, particularly in terms of sustainability work.

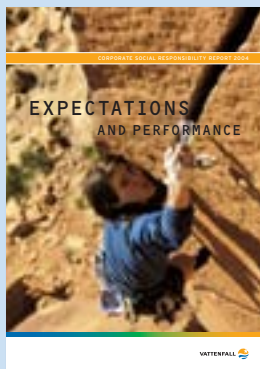
On the opposite page we provide examples of the results of our efforts.

Sustainability work – part of everyday life

In the development of energy solutions suited to sustainable societal development, we need to consider the big picture, not just the breakthroughs. Day-to-day work to improve and optimise operations is the work that will provide lasting results. Responsibility for sustainability work at Vattenfall is not held by a particular department or organisation, instead it is governed at Group level along the same lines as other strategic issues. Day-to-day sustainability work is conducted at Business Group level, making it a natural part of Vattenfall's work; the entire company is responsible for achieving positive effects for society and the environment.

In order to be number one for the environment, the customer and the economy, we must continually work to reduce the environmental impact of our operations. We need to squeeze out even more usable energy from fuels, reduce energy losses and secure availability for our customers. If we are to be a positive force in society, then we must act to ensure the company's long-term profitability.

Corporate Social Responsibility report



Each year Vattenfall publishes a sustainability report. The aim of this report is to provide a balanced picture of Vattenfall's efforts as regards the environment, society and the economy. Vattenfall's sustainability reporting follows the GRI (Global Reporting Initiative) guidelines, the most widely used standard for sustainability reports. The Corporate Social Responsibility Report (in English) and offprints (in Swedish, German, Finnish and Polish) can be downloaded from www.vattenfall.com. There you can also order printed copies.

Development and results in recent years

Environment

- Since 1997, more than SEK 8 billion has been invested in renewable energy sources and production capacity in the Nordic countries alone.
- Several major investment decisions on renewable energy sources were recently made concerning, for example, hydro power, off-shore wind power and several biofuel and waste-fired plants.
- The work to optimise our plants has continued to produce results, leading to reduced emissions and more efficient use of resources.
- Combined Heat and Power (CHP) plant utilisation has been improved.
- Extensive development projects for carbon dioxide-free power generation have been launched – work with a pilot installation for a “carbon dioxide-free coal-fired power plant” has begun.
- Increased combined combustion of biofuel and coal has replaced other fossil fuels in certain plants.
- Participation in several research projects in the EU and at national level with a focus on, for example, wave power, hydrogen gas, black liquor gasification, fuel cells, geothermal power and solar energy.
- Work to restore mining areas in Germany continues. The land area restored so far corresponds to the new open-cast mine land area.
- Vattenfall has taken an active role in finding long-term solutions to the climate change issue. The issue has been lobbied within, for example, the World Economic Forum, G8 and the electricity sector's collaborative organisations with an emphasis on the energy sector's considerable role in making progress.
- TIME Magazine named Lars G. Josefsson one of its “European Heroes 2005” for his efforts on the issue of climate change.

Society

- A five-year SEK 10 billion investment programme was initiated in Sweden in 2004 with the aim of increasing network reliability. New network monitoring systems have been introduced in Sweden and Finland.
- In Sweden, work has begun on the SEK 24 billion nuclear power investment programme and the SEK 6.5 billion hydro power investment programme. In Germany, the work to optimise and adjust safety levels at nuclear power plants continues.
- Vattenfall takes responsibility for development in the regions where we operate. Examples of this include the projects “Inland power” in northern Sweden, “Initiative for employment” in Germany and “Switch to Silesia” in Silesia, Poland.
- Remote-readable electricity meter installations are now underway in Finland and Sweden. The aim is for all customers to have remote-readable meters by 2009.
- The Group's customer service via telephone has been improved. A customer ombudsman has been appointed in Sweden.
- The “My Opinion” employee survey has shown that our employees are more satisfied than ever with their work situation.
- The “Young Academics” project continues. Of the 45 newly graduated academics that completed the project at the beginning of 2005, 37 have continued their employment at Vattenfall. In 2006, 20 new graduates will be offered employment on a project basis.

Economy

For figures and financial performance in accordance with the GRI guidelines, please refer to Vattenfall's Corporate Social Responsibility Report 2004. The corporate social responsibility report for 2005 will be published in September 2006.



TO BECOME "NUMBER ONE FOR THE ENVIRONMENT"

"WE WILL SOON BE ONE OF EUROPE'S LARGEST WIND POWER PRODUCERS"

Seven kilometres behind Anders Dahl is the place where Sweden's largest wind power farm will be built. Construction work will begin in March 2006 and in November 2007, 48 wind turbines will contribute to the electricity supply in southern Sweden.

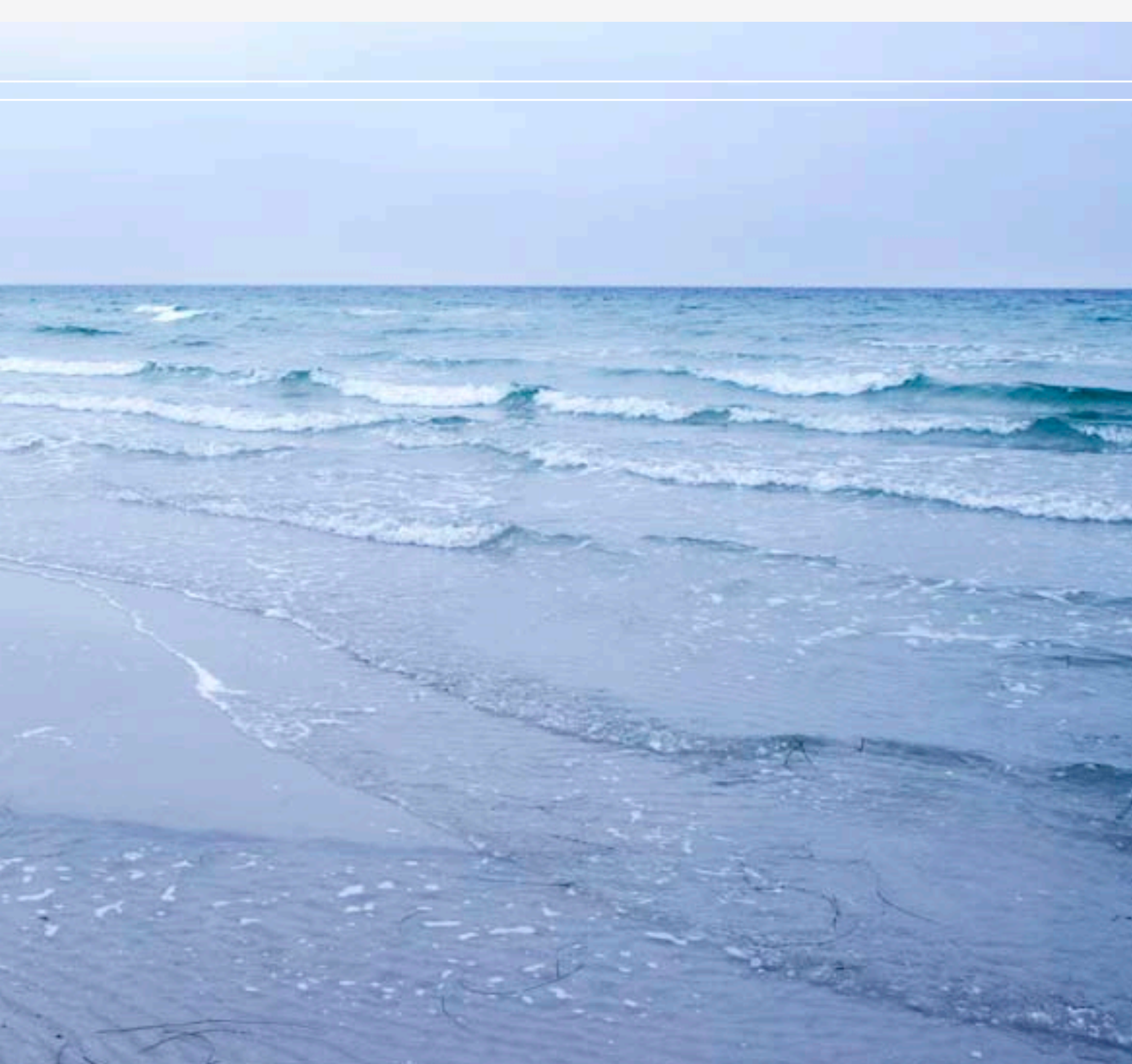
"This is most exciting, and a significant step in the process to develop our renewable energy production," says Anders Dahl, head of wind power operations at Vattenfall Nordic.

The steady, strong sea winds (averaging 8.5 metres per second) can generate enough electricity for 60,000 households - without any emissions or waste. Some environmental impact

may be felt by sea life during the construction work.

"But we are conducting extensive environmental controls both before and after putting the turbines in operation, and most results would indicate only marginal effects," says Anders Dahl. "We know from experience from other plants that there are some positive effects to expect, such as increased fish stocks."

Vattenfall has worked with wind power for almost 30 years. But it is only recently that commercial development has really taken off. This is among other things due to the planned prolongation of the green certificate system to 2030, which would



mean a long-term, stable and predictable subsidy system. "It would improve the conditions for profitable wind power," says Anders Dahl.

With Lillgrund, Vattenfall will suddenly be by far the largest wind power producer in the Nordic countries – moving from 8 to 42 per cent of total wind power generation.

Vattenfall is also investigating the possibility of – and has applied for a permit for – building northern Europe's largest wind power farm at Kriegers Flak between Germany and Sweden. Fully developed, this would involve 100–150 wind turbines with a combined generation capacity of about 1.6 TWh per annum. This requires, however, a positive decision on the planned long-term green certificate system.

"It is very exciting to create new electricity generation facilities with good environmental performance on this scale. It is a bit like a take-off – now we are off the ground," says Anders Dahl.

Facts about Lillgrund

48 wind turbines. Capacity: 110 MW. Generation: 330 GWh. Total height: 115 metres. Rotor diameter: 92 metres.

The world's first carbon dioxide-free coal-fired power plant

In May 2005, Vattenfall decided to build the world's first pilot installation for a carbon dioxide-free coal-fired power plant. The installation will be built adjacent to Vattenfall's Schwarze Pumpe coal-fired plant in eastern Germany. The technique is based on separating and capturing the carbon dioxide and storing it in the bedrock. The plant is expected to be in operation in 2008 and the investment totals about SEK 370 million. "With this installation we are taking a leading role in the development of future, more climate-friendly energy generation from lignite," says Dr. Klaus Rauscher, Head (Vorstandsvorsitzender) of Vattenfall Europe.

Other investments

- Development of combined combustion of biofuel and coal at the Zerań plant in Warsaw, Poland.
- New state of the art plants in Hamburg and Uppsala that convert waste into energy.
- Investments in existing hydro power plants in the Nordic countries to increase capacity.
- Participation in national and European research projects on future production techniques, such as wave power, hydrogen gas, solar energy and fuel cells.
- Decision on new environmental management system at Group level.

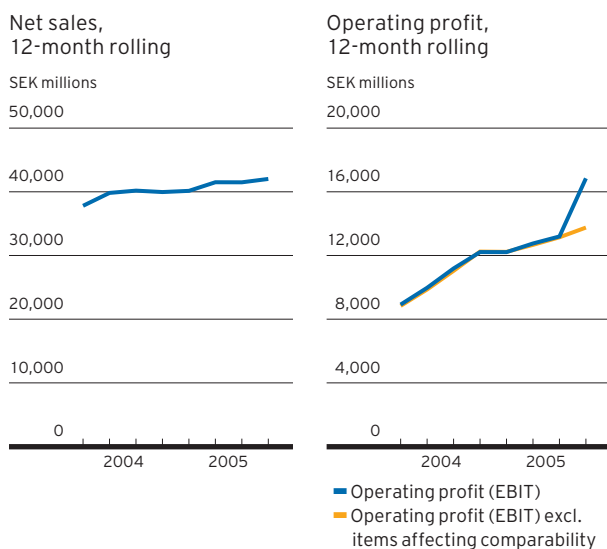
BEST RESULT EVER DUE TO INCREASED HYDRO POWER GENERATION

Again, Nordic operations reported improved financial performance, mainly due to increased hydro power generation. A major investment was made in Denmark and several new long-term supply agreements were signed with large industrial customers.

Vattenfall generates, distributes and sells electricity and heat in the Nordic countries. In addition Vattenfall also sells telecom and broadband services, as well as consulting and contracting services, primarily within the energy sector. Vattenfall has about 937,000 electricity customers and 1,291,000 network customers in the Nordic market. Vattenfall's market position in the Nor-

dic Countries is number one in electricity generation, number two in electricity distribution and positions one and three in electricity supply to end-customers in Sweden and Finland respectively. In 2005, nuclear power and hydro power represented 58.8 and 40.5 per cent respectively and comprise the foundation of Vattenfall's electricity generation. A little more than 75 per cent of heat generation is based on biofuel, although fossil fuels and waste are also used. Operations are organised in six business units, which are coordinated under Business Group Vattenfall Nordic. (See page 52).

Vattenfall in the Nordic Countries



Best results ever

Operating profit, excluding items affecting comparability, increased by 12.3 per cent, mainly due to significantly increased hydro power generation, higher electricity wholesale prices and improved hedging outcomes. Hydro power generation increased due to considerably improved water supply; on average a surplus in the Nordic hydrological balance of 7 TWh in 2005 compared to a deficit of 13.8 TWh in 2004.

Electricity Generation shows the greatest improvement, which is due to the compensation of SEK 3 billion net for lost production connected with the closure of Barsebäck 2, increased generation volumes,

Key figures - Nordic Countries

(SEK million unless otherwise stated)

		2005	2004	Change, %
Net sales	▲	42,021	39,962	5.2
EBIT	▲	16,845	12,215	37.9
EBIT excl. items affecting comparability	▲	13,755	12,246	12.3
Operating margin, %	▲	40.1	29.9	-
Net assets	▲	77,190	57,415	34.4
Return on net assets, %	▲	25.5	21.2	-
Return on net assets excl. items affecting comparability, %	▼	20.9	21.3	-
Electricity generation capacity, MW	▼	16,355	16,878	-3.1
Heat generation capacity, MW	▼	3,440	3,523	-2.4
Electricity generation, TWh	▲	89.8	88.4	1.6
Heat generation, TWh	▼	7.3	7.6	-3.9
Number of electricity customers	▲	937,000	934,000	0.3
Number of network customers	▲	1,291,000	1,278,000	1.0

	Challenges for 2005	Measures 2005	Forecasts and strategy
Electricity Generation	<ul style="list-style-type: none"> Acquire wind and CHP plants in Denmark Extend lifetime, further improve safety and efficiency within existing power plants Maintain high availability during ongoing maintenance work The Swedish government's decision to close Barsebäck 2 by 31 May 2005 	<ul style="list-style-type: none"> Closure of Barsebäck 2 Agreement signed with Swedish state on handling the closure of Barsebäck Continued optimisation of generation within existing nuclear power and hydro power facilities. Investments in, among other things, new turbines that increased power output Decision to build Lillgrund – Sweden's largest wind power project 	<ul style="list-style-type: none"> Integration of new operations in Denmark Maintenance and efficiency improvement programme for nuclear and hydro power Safety upgrades for dams Increased utilisation of existing generation facilities Construction of Lillgrund 110 MW wind power farm Continued evaluation of renewable energy sources which meet green certificate requirements
Distribution	<ul style="list-style-type: none"> Increase confidence among customers Increase reliability of supply (fewer and shorter disruptions) The Swedish network regulator's application of the regulatory model "the network performance assessment model" 	<ul style="list-style-type: none"> Continued installation of remote-readable meters, a total of about 270,000 meters installed at year-end Investment and maintenance programme for increased reliability of supply and strengthened contingency organisation Extensive work with tariff regulation issues Implementation of new operations monitoring system 	<ul style="list-style-type: none"> Optimise and simplify management of customer issues with a genuine customer focus Introduction of a new business system Further increase investment rate and complete quality improvements in electricity networks Continued installation of remote-readable meters Extensive work with tariff regulation issues Active dialogue with Swedish network regulator on regulation Increase cost-efficiency
Sales	<ul style="list-style-type: none"> Create a joint Nordic sales organisation by merging three sales units Ensure growth through increased quality that increases customer satisfaction Create understanding and acceptance for pricing Ensure long-term competitive edge through increased cost-efficiency Ensure successful implementation of new cost-effective business system 	<ul style="list-style-type: none"> Introduced new Nordic management model for the entire sales organisation Implemented new business system in Finland Developed a Nordic analysis in collaboration with Vattenfall Trading Services to ensure effective hedging Implemented new pricing strategies Implemented and expanded cost-efficiency programme 	<ul style="list-style-type: none"> Profitable growth under own brand Continued work to increase quality and thereby increase confidence and customer satisfaction Finalise implementation of new business system in Sweden Become a leading player in sales processes and systems in the Nordic countries
Heat	<ul style="list-style-type: none"> Increase customer satisfaction Optimise fuel composition and reduce operating and maintenance costs Reduce emissions 	<ul style="list-style-type: none"> Customer satisfaction increased (according to Swedish customer satisfaction index, NKI) Long-term agreements on district heating closed with Akademiska Hus and Uppsalahem in Uppsala New waste incinerator in Uppsala commissioned (earlier than planned) that reduces fuel costs and improves environmental performance Renovation of CHP plant in Uppsala Reduced emissions through continued increased focus on biofuel and new catalysator. Nitric oxide (Nox) emissions reduced by 75 per cent 	<ul style="list-style-type: none"> Continued work to increase market confidence New district heating plant in Gustavsberg and renovated CHP plant in Uppsala Continued optimisation and cost reductions Growth in district heating segment through acquisitions for long-term profitability Continued uncertainty about tax on waste incineration that could drastically decrease profitability on the new waste incinerator in Uppsala
Services	<ul style="list-style-type: none"> Market level profitability in all operations Continued growth and increased external sales 	<ul style="list-style-type: none"> Recruitment of strategic resources to manage the large reinvestment programme in the energy sector and transfer of know-how from senior to junior employees Development of existing customer agreements in terms of, for example, common working methods and development efforts Developed maintenance services through increased total commitments to customers Vattenfall Utveckling AB transferred to Research and Development unit within Group Function Strategies 	<ul style="list-style-type: none"> Ensure resource and expertise supply for the future Continued development of maintenance services through increased total commitments to customers that increase/secure the value of the customer's facilities Expand and strengthen consulting activities' position in the energy sector Consulting activities in the subsidiary Swedpower change name to Vattenfall Power Consultant AB

higher wholesale prices and better hedging outcomes. Heat, too, exhibits considerable improvements due to increased income from Swedish green certificates and due to the fact that the result for 2004 was burdened by SEK 100 million for the disposal of the peat producer Härjedalens Mineral AB. Distribution shows weakened operating profit due to the severe storm "Gudrun" that affected southern Sweden in January, and which burdened the result by more than SEK 500 million. In addition, costs for increased measures to improve the electricity network have reduced profitability. Operating profit for Sales was largely unchanged.

Hydro power generation was 6.1 TWh higher than in 2004 while nuclear power generation was 4.6 TWh lower. Total generation increased by 1.4 TWh. The reduction in nuclear power is due to the closing of Barsebäck 2 in May and certain outages at the Ringhals plant. Heat generation was 0.3 TWh lower due to warmer weather.

Major investment in Danish power plants

In April, Vattenfall acquired 35.3 per cent of the shares in the Danish company Elsam for approximately SEK 10.3 billion. According to an agreement in principle signed with Dong, Vattenfall intends to exchange the shares for a number of Danish CHP and wind power plants with a total generation capacity of approximately 2,500 MW electricity and 2,100 MW heat, corresponding to annual volumes of about 6 TWh each. The EU's anti-trust authority gave its approval to Vattenfall's part in the transaction on 23 December.

Nuclear power

Barsebäck 2 was closed on 31 May. After negotiations between the Swedish state, E.ON Sverige and Vattenfall, we have received fair compensation for the loss of generation. (For more information, see the Administration Report on page 65).

There are no formal plans for decommissioning Sweden's remaining 10 reactors. Vattenfall has initiated an extensive investment programme for its 7 reactors (capital expenditures for 2005 and 2004 are presented in the table on page 65).

Electricity network companies under review

The Swedish network regulator, the Energy Markets Inspectorate (Energimarknadsinspektionen, EMI), supervises the network tariffs. In 2004, 40 network companies were selected for closer review of their network tariffs in 2003. Vattenfall Sveanät AB, which is now a part of Vattenfall Eldistribution AB, was one of these companies. In February 2006, the EMI requested Vattenfall to repay SEK 236 million, which Vattenfall will appeal. In 2005, some 50 network companies were selected for review of 2004 year's tariffs. Vattenfall Eldistribution AB's southern Sweden price area is among them. The EMI has not yet made any decisions concerning this review.

New major industrial agreements

In 2005, Vattenfall signed several new agreements with major industrial customers, including: Holmen (1.5 TWh per annum for 10 years), Stora Enso (8 years), SCA (1.3 TWh per annum for 8 years) and Saab (portfolio management and electricity supply).

Continued work to increase customer satisfaction

The energy sector has continued to be the object of much debate and criticism. Vattenfall takes this criticism very seriously and is devoting extensive resources to continue improving confidence and customer satisfaction.

Vattenfall measures customer satisfaction with a model based on a customer satisfaction index (NKI). In the Swedish market, we also compare the results with a Swedish quality index (SKI), an independent instrument to measure and analyse how customers judge goods and services in Sweden. In the autumn of 2005, Vattenfall received a rating of 58.7 (57.5). Among the major electricity utilities, Vattenfall is at the top. However, if we compare ourselves with smaller electricity suppliers and other sectors, we have some progress to make before reaching our goal to be the company that sets the standard.

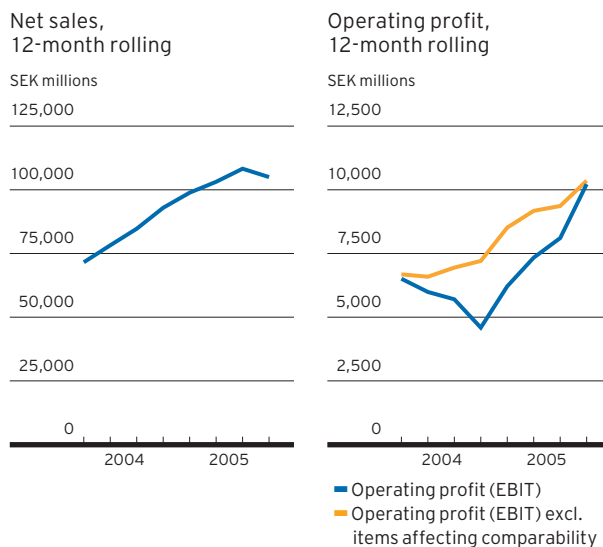
STRONG DEVELOPMENTS IN GERMAN OPERATIONS

Almost all business units increased their operating profit in 2005. The improvements were primarily due to higher electricity wholesale prices. Total electricity generation increased by 0.7 per cent. Nuclear power and hydro power generation was higher than in 2004 while fossil-based power fell somewhat.

Vattenfall generates, transmits, distributes and sells electricity and heat in Germany. Vattenfall's market position in Germany is number three in electricity generation, number four in electricity supply to end-customers, number three in transmission and number

four in electricity distribution. Within district heating, Vattenfall is the largest player with the longest district heating network in Europe. Vattenfall's generation in Germany consists of 87 per cent fossil-based power, which is produced in some of the world's most modern and cleanest lignite-fired plants. The remaining electricity generation sources are primarily nuclear power and hydro power. Business Group Vattenfall Europe coordinates the German business units. (See page 52).

Vattenfall in Germany



Key figures - Germany

(SEK million unless otherwise stated)

		2005	2004	Change, %
Net sales	▲	104,995	92,945	13.0
EBIT	▲	10,221	4,591	122.6
EBIT excl. items affecting comparability	▲	10,359	7,208	43.7
Operating margin, %	▲	9.7	6.9	-
Net assets	▲	68,717	58,350	17.8
Return on net assets, %	▲	14.8	6.4	-
Return on net assets excl. items affecting comparability, %	▲	15	10.1	-
Electricity generation capacity, MW	▶	15,112	15,112	-
Heat generation capacity, MW	▼	7,528	9,096	-17.2
Electricity generation, TWh	▲	75.9	75.5	0.7
Heat generation, TWh	▼	15.4	15.5	-0.6
Number of electricity customers	▼	2,916,000	2,935,000	-0.6
Number of network customers	▲	3,399,000	3,393,000	0.2

krona (SEK). The operating profit of all business units, apart from Distribution, improved. The Mining and Generation business unit, responsible for the greater proportion of profit earned, saw an improvement in operating profit of 34 per cent in local currency compared with 2004. Sales turned the negative result of 2004 into a positive operating profit through reduced sales and administration costs as well as through alignment to market terms of a number of large sales agreements. The Heat business unit was able to increase its operating profit by approximately 7 per cent in local currency despite stagnant heat generation volumes due to warm weather. Distribution showed a deterioration of 21 per cent which is chiefly explained by lower connection fees and increased costs for the upstream network.

Electricity and heat generation

The generation of nuclear power and hydro power was higher in 2005 than 2004 while fossil-based power fell somewhat. Overall, electricity generation increased by 0.7 per cent. The 3,000 MW Jämschwalde plant achieved its best generation results ever. Heat generation was marginally lower.

Squeeze-out of minority shares in Germany

In August, Vattenfall AB announced that its shareholding in the listed German subsidiary Vattenfall Europe AG exceeds 95 per cent. In December, the decision was made to hold an extra general meeting in March 2006 at Vattenfall Europe AG for a decision on the squeeze-out of the minority owners' shares.

Pilot installation for carbon dioxide-free coal-fired power plant

Vattenfall is to build the world's first pilot installation for a carbon dioxide-free coal-fired power

plant based on so-called oxyfuel technology. The installation, which costs approximately SEK 370 million, will be built adjacent to Vattenfall's Schwarze Pumpe coal-fired power plant in East Germany and is expected to be commissioned in 2008.

New energy law in Germany

On 13 July, the new German energy industry act (EnWG) came into force. As a result, the new German network regulator, Bundesnetzagentur, could start its work. Initially, all tariff changes must be approved in advance by the regulator. Transition to an incentive-based regulatory model is planned for 2007. According to EU regulations, network operations must be legally separated from generation and sales (legal unbundling) – as was done in the Nordic countries back in 1996. Extensive preparations were made to be able to launch the new network organisation on 1 January 2006.

Investments in a common brand

In January 2006, Vattenfall's German subsidiaries Bewag and HEW began operating under the name Vattenfall. This is a natural step in the development of Vattenfall in Germany as a part of a European company and in the establishment of One Vattenfall.

Allocation of emission allowances for carbon dioxide

Within the framework of the German national allocation plan Vattenfall has essentially obtained the necessary number of emission allowances for carbon dioxide for the initial trading period 2005–2007. In the allocation process, Vattenfall's extensive early actions to reduce emissions, carried out in the 1990s, were recognised to a large extent.

	Challenges for 2005	Measures 2005	Forecasts and strategy
Generation	<ul style="list-style-type: none"> • Guarantee the availability of facilities during heavy loads • The new trading system for carbon dioxide emission allowances 	<ul style="list-style-type: none"> • Began planning for new power plants in Lausitz and Hamburg • Decision to build a carbon dioxide-free coal-fired power plant based on oxyfuel technology • Prepared to recommission the Reichwalde lignite open-cast mine 	<ul style="list-style-type: none"> • Continued development of new sustainable generation technology (carbon dioxide-free power plant, offshore wind power) • Negotiate allocation of emission allowances for the second trading period (2008–2012) and thereafter • Continued identification of potential efficiency improvements
Transmission	<ul style="list-style-type: none"> • Manage increased wind power input • Ensure a fair distribution of network expansion costs due to increased wind power input • Planning process for EEG-related (German renewable energy law) investments • Begin collaboration with the newly introduced German network regulator Bundesnetzagentur • Prevent bottlenecks in the transmission system 	<ul style="list-style-type: none"> • EEG-related investments planned • Communication group to manage transmission/distribution issues • Started construction of two new transmission lines (Northern and Southwest) • Maintenance upgrade • Joint network capacity auctions together with the Czech and Polish Transmission System Operators (TSOs) 	<ul style="list-style-type: none"> • Investments to avoid bottlenecks • Provide Bundesnetzagentur with necessary data and documentation • Continue to invest in customer-related projects and expand the network for the European market • Actively provide support for further development of the balancing power and the intraday markets
Distribution	<ul style="list-style-type: none"> • New energy industry act (EnWG) • Legal and functional separation and division into two distribution companies (DSOs) in Hamburg and Berlin 	<ul style="list-style-type: none"> • Legal unbundling and division into two distribution companies (DSOs) in Hamburg and Berlin 	<ul style="list-style-type: none"> • Prepare to implement new incentive based network regulatory model • Identify future cost optimisation potential
Sales	<ul style="list-style-type: none"> • Finalise market-adaptation of sales contracts • Introduce new business model • Adapt bills to new EnWG requirements, chiefly concerning the source of generated electricity • Transition from the “Bewag” and “HEW” brands to the common “Vattenfall” brand 	<ul style="list-style-type: none"> • Customer centres established in Berlin and Hamburg in line with legal requirements (unbundling) • Extensive information and communication activities concerning the brand transition • Product development in the corporate customer segment • Competence development in risk management 	<ul style="list-style-type: none"> • Additional cost optimisation • Concentration on core activities electricity and electricity-related services • Increase customer focus in all segments • Maintain market leadership in Berlin and Hamburg
Heat	<ul style="list-style-type: none"> • Prices for CO₂-allowances affect planning for thermal power plants • Optimise generation scheduling • Utilise market opportunity in waste incineration • Cost leadership 	<ul style="list-style-type: none"> • Concentration of heating networks in Hamburg and Berlin • Growth project in Hamburg approved 	<ul style="list-style-type: none"> • Generate growth through several investment projects in Berlin and Hamburg • Focus on district heating in Hamburg and Berlin • Continue to benchmark against other power companies • Retain and increase the high levels of customer satisfaction



TO BECOME "NUMBER ONE FOR THE CUSTOMER"

"VATTENFALL IS AHEAD OF THE COMPETITION"

A customer with 65,000 stations and connection points dependent on a reliable electricity supply. It is not every company that can meet this logistical challenge.

In 2000, Vattenfall became the largest electricity supplier to Deutsche Telekom – one of the world's largest telecom companies. In 2005, Vattenfall delivered some 1.3 TWh to Deutsche Telekom (if this was household electricity, it would be sufficient for a quarter of a million single-family houses).

"In the beginning, we chose Vattenfall mostly because of pricing. But service and flexibility have become more important factors for us," says Goetz Wolf (to the left in the picture above), Head of Power and Air Condition Solution Management at Deutsche Telekom.

Deutsche Telekom is one of Vattenfall's largest customers in Germany and due to its size the company gets a great deal of additional service from Vattenfall.



"We have a special helpdesk for Deutsche Telekom, able to deal with ongoing questions and urgent issues," says Carsten Herrmann (to the right in the picture above), Key Account Manager at Vattenfall with a focus on telecom customers.

Carsten Herrman and Goetz Wolf get in touch a few times a month to check that everything is running smoothly.

"I think the service we can provide our customers is at least as important as our pricing," says Carsten Herrman and lists a few of the administrative tasks Vattenfall has simplified, such as introducing electronic invoice payments and an IT portal where customers can check their consumption, price levels and more.

But service is also about other matters, such as helping out with signing agreements with different network companies and advising on long-term electricity trading strategies.

"This year we will start trading in electricity on the OTC market and need a partner who can help us in our electricity transactions. And Vattenfall is the best alternative. We can discuss new strategies and methods with them – Vattenfall is ahead of the competition," Goetz Wolf concludes.

Power-intensive industries choose Vattenfall

In Sweden, Vattenfall closed several major industrial agreements during the year. In June, an eight-year agreement was signed with the pulp and paper group SCA, which is one of Sweden's largest electricity consumers. Vattenfall will deliver 1.3 TWh per year to SCA until 2013. "We are very pleased that Vattenfall has listened to and understood our needs," says Kenneth Eriksson, head of forestry industry products at SCA. Forestry company Holmen also signed a long-term agreement with Vattenfall, entailing the delivery of 1.5 TWh per annum for the next ten years. According to the agreement, Vattenfall will also conduct energy efficiency work at Holmen's plants.

Other events in the Group

- The new Internet service in Poland, IBO, gives 45,000 corporate customers the opportunity to monitor their power transactions.
- The first Customer Call Centre in Poland, able to handle 100,000 calls, e-mails and faxes per month, was opened.
- In the Nordic countries work continues on the installation of remote-readable meters for all household customers.
- In 2005, all customer groups in the Nordic market rated Vattenfall higher in the customer satisfaction index, compared with the previous year.
- Saab AB has transferred its portfolio management for all its electricity transactions to Vattenfall Nordic. According to the agreement, Saab will also buy electricity from Vattenfall.

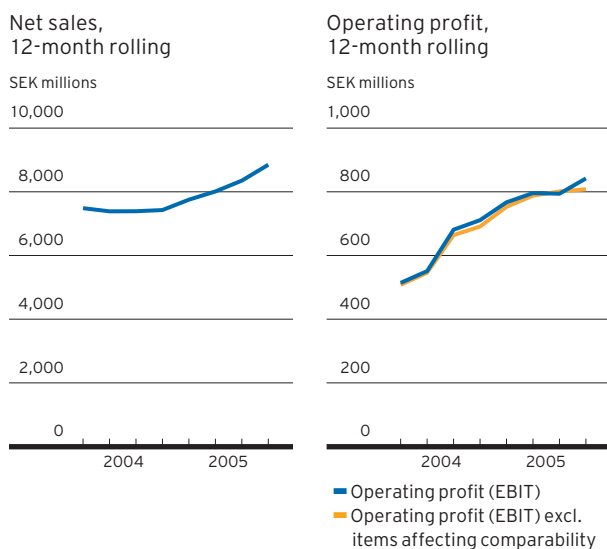
STABLE PERFORMANCE IN POLAND

Vattenfall's Polish operations recorded a stable result for 2005. During the year operations were divided into three business units: Distribution, Sales and Heat.

Vattenfall generates, distributes and sells electricity and heat in Poland. Heat (and to a lesser extent electricity) are generated through the company Vattenfall Heat Poland (formerly EW), of which Vattenfall owns 75 per cent. Distribution and sales of electricity take place through the company GZE in which Vattenfall's shareholding is 75 per cent. As of 1 January 2006, operations in these companies are conducted under

the Vattenfall name. With these two companies, Vattenfall is the largest foreign investor in the Polish energy sector with a market share of about 7 per cent. We are also the largest privatised distribution company in Poland with market shares of about 9 per cent in sales and 11 per cent in distribution. Of Poland's 33 distribution companies, only two companies have been privatised so far. Vattenfall Heat Poland is the largest heat producer in Poland, with a market share of 27 per cent. The company also generates 3 per cent of Poland's electricity in its CHP plants. Business Group Poland coordinates the Polish business units. (See page 52).

Vattenfall in Poland



Financial development in 2005

Poland shows a stable underlying result for 2005. The Heat business unit accounts for approx. two thirds of operating profit. The major part of the increase in both sales and operating profit for Poland is due to exchange rate effects as the Swedish krona weakened against the Polish currency in 2005. In local currency, sales and operating profit improved by approx. 4 per cent. Generated heat volumes were unchanged compared with 2004 while electricity generation increased somewhat.

Key figures - Poland

(SEK million unless otherwise stated)

		2005	2004	Change, %
Net sales	▲	8,850	7,427	19.2
EBIT	▲	842	711	18.4
EBIT excl. items affecting comparability	▲	808	691	16.9
Operating margin, %	▲	9.5	8.0	-
Net assets	▲	9,295	7,187	29.3
Return on net assets, %	▼	10.1	10.6	-
Return on net assets excl. items affecting comparability, %	▼	9.7	10.3	-
Electricity generation capacity, MW	▲	981	928	5.7
Heat generation capacity, MW	▲	4,996	4,824	3.6
Electricity generation, TWh	▲	3.4	3.2	6.3
Heat generation, TWh	▶	11.4	11.4	-
Number of electricity customers	▲	1,104,000	1,100,000	0.4
Number of network customers	▲	1,104,000	1,101,000	0.3

	Challenges for 2005	Measures 2005	Forecasts and strategy
Distribution	<ul style="list-style-type: none"> Continued optimisation of operations Reduce network losses (electricity theft) Functional separation and unbundling of distribution activities Manage tariff regulation issues 	<ul style="list-style-type: none"> Streamlined administration through the creation of an accounting and logistics centre Successful "anti-theft" programme to reduce network losses Centralisation of dispatch Created a distribution system operator (DSO) Restructuring of the two merged service companies within GZE 	<ul style="list-style-type: none"> Continue to optimise operations to become a benchmark, even internationally Continue to improve the technical service level in the networks and continue to reduce network losses Legal unbundling of distribution activities Strategy for tariff regulation issues
Sales	<ul style="list-style-type: none"> Functional separation – create the new Sales business unit Organisational changes in order to focus on core Sales activities Prepare for fully deregulated operations 	<ul style="list-style-type: none"> Created Sales business unit Established Vattenfall Trading Services in Poland Established a joint customer service centre with Distribution Improved customer satisfaction 	<ul style="list-style-type: none"> Legal unbundling of sales activities Implement new billing system Optimise unit for fully deregulated sales operations in Poland
Heat	<ul style="list-style-type: none"> Continued optimisation of operations Organic growth Manage tariff regulation issues 	<ul style="list-style-type: none"> Commission the new turbine at the CHP plant Zerań Higher electricity generation due to continued optimisation of production planning Divestment of non-core activities, such as coal transport and real estate 	<ul style="list-style-type: none"> Continue to optimise operations to become a benchmark internationally Organic growth Develop a strategy for trading in emission allowances for carbon dioxide in collaboration with Vattenfall Trading Services Strategy for tariff regulation issues

Poland reorganised as Business Group

Operations in Poland have been reorganised into Business Group Poland and sub-divided into three business units: Distribution, Sales and Heat. This puts Poland on the same level in the Group as Business Group Vattenfall Nordic and Business Group Vattenfall Europe in Germany.

Newly opened trading office in Poland

Vattenfall has opened a new trading office in Poland, the first step in developing Vattenfall's trading activities in the Polish market. The company, which is based in Gliwice, is part of the central trading organisation Vattenfall Trading Services. Vattenfall is one of the first foreign companies in the Polish energy market to establish trading activities.

The Vattenfall brand

The Vattenfall brand has now been introduced in Poland and as of 1 January 2006 all activities are conducted under the Vattenfall brand. The subsidiary EW changed its name to Vattenfall Heat Poland. Two

business units were established within the subsidiary GZE which now operate under the brands Vattenfall Sales Poland and Vattenfall Distribution Poland.

Fewer M&A transactions than expected

Poland is now a member of the EU and expectations for continued mergers and acquisitions in the energy sector have been high. Privatisation of the state-owned power companies has, however, come to a standstill due to, among other things, uncertainties as regards regulations. For potential investors, requirements as regards capital expenditures, synergies and possibilities to rationalise are important factors in any assessment. Vattenfall has evaluated the objects put out for tender and has made indicative bids for the more interesting objects, though without resulting in any final transactions.

FACTS ABOUT VATTENFALL'S MARKETS

(According to IFRS consolidation principles)

	Nordic Countries		Germany		Poland		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
Electricity & heat generation capacity, MW								
Hydro power	8,399	8,386	2,894	2,894	–	–	11,293	11,280
Nuclear power	6,697	7,242	771	771	–	–	7,468	8,013
Fossil-based power	1,068	1,004	11,371	11,371	981	928	13,420	13,303
Wind power	31	31	41	41	–	–	72	72
Biofuel, waste	160	215	35	35	–	–	195	250
Total electricity	16,355	16,878	15,112	15,112	981	928	32,448	32,918
Total heat	3,440	3,523	7,528	9,096	4,996	4,824	15,964	17,443
Generated electricity, TWh								
Hydro power	36.4	30.3	3.5	3.3	–	–	39.9	33.6
Nuclear power	52.9	57.5	6	4.9	–	–	58.9	62.4
Fossil-based power	–	0.1	66.4	67.2	3.4	3.2	69.8	70.5
Wind power	0.1	0.1	–	–	–	–	0.1	0.1
Biofuel, waste	0.4	0.4	–	0.1	–	–	0.4	0.5
Total electricity	89.8	88.4	75.9	75.5	3.4	3.2	169.1	167.1
Generated heat, TWh								
Fossil-based power	1.5	2.1	14.3	14.4	11.4	11.4	27.2	27.9
Biofuel, waste	5.5	5.2	1.1	1.1	–	–	6.6	6.3
Other	0.3	0.3	–	–	–	–	0.3	0.3
Total heat	7.3	7.6	15.4	15.5	11.4	11.4	34.1	34.5
Number of electricity customers	937,000	934,000	2,916,000	2,935,000	1,104,000	1,100,000	4,957,000	4,969,000
Number of network customers	1,291,000	1,278,000	3,399,000	3,393,000	1,104,000	1,101,000	5,794,000	5,772,000
Electricity Networks								
Transmitted volume, TWh	83.5 ¹	80.3 ¹	28.2 ²	28.5 ²	10.4	10.6	122.1	119.4
Number of km								
Transmission grid	–	–	10,000	10,000	–	–	10,000	10,000
Distribution network	187,700	188,100	75,000	75,000	26,800	27,500	289,500	290,600
Number of employees								
Business Groups	8,788	8,735	20,096	20,864	3,029	3,309	31,913	32,908
Total Vattenfall ³							32,231	33,017

1) Excl. production transmission

2) Excl. transmission grid

3) There are 318 (109) employees in other than Nordic Countries, Germany and Poland

	2005	2004
Electricity trading, TWh ⁴	1,100	859

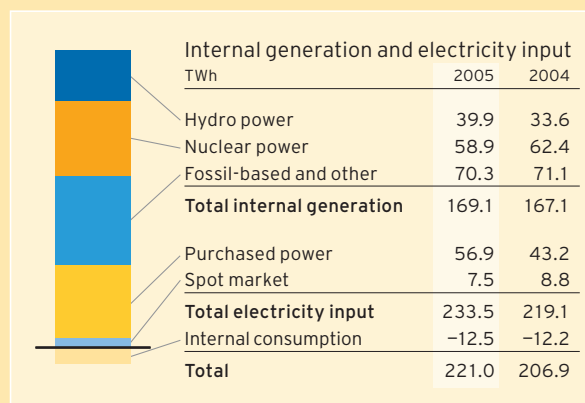
4) OTC and electricity exchange

Pro rata – Production data corresponding to Vattenfall's ownership

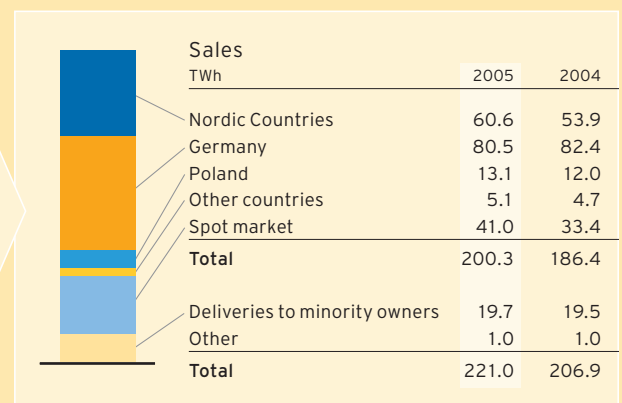
	Nordic Countries		Germany		Poland		Total	
	2005	2004	2005	2004	2005	2004	2005	2004
Electricity & heat generation capacity, MW								
Hydro power	8,155	7,935	2,894	2,894	-	-	11,049	10,829
Nuclear power	4,577	5,119	1,409	1,409	-	-	5,986	6,528
Fossil-based power	1,054	990	11,371	11,371	732	692	13,157	13,053
Wind power	30	30	41	41	-	-	71	71
Biofuel, waste	160	160	35	35	-	-	195	195
Total electricity	13,976	14,234	15,750	15,750	732	692	30,458	30,676
Total heat	3,300	3,380	7,528	9,096	3,727	3,597	14,555	16,073
Generated electricity, TWh								
Hydro power	35.0	29.4	3.5	3.3	-	-	38.5	32.7
Nuclear power	36.6	40.7	10.8	10.2	-	-	47.4	50.9
Fossil-based power	-	0.1	66.4	67.2	2.6	2.4	69.0	69.7
Wind power	0.1	0.1	-	-	-	-	0.1	0.1
Biofuel, waste	0.5	0.6	-	-	-	-	0.5	0.6
Total electricity	72.2	70.9	80.7	80.7	2.6	2.4	155.5	154.0
Generated heat, TWh								
Fossil-based power	1.4	1.9	14.3	14.4	8.6	8.5	24.3	24.8
Biofuel, waste	5.3	5.0	1.1	1.1	-	-	6.4	6.1
Other	0.3	0.3	-	-	-	-	0.3	0.3
Total heat	7.0	7.2	15.4	15.5	8.6	8.5	31.0	31.2

Vattenfall's electricity balance

Vattenfall's electricity generation



Vattenfall's electricity sales



Comments: The increase in sales totalling 6.8 per cent is explained by increased bilateral sales, primarily in the Nordic countries, and increased sales in the spot market. The increase in production is explained by a dramatic increase in hydro power generation due to good water supply. The

production of nuclear power fell due to the closing of Barsebäck 2 as well as certain outages at the Ringhals plant. Fossil-based power fell somewhat due to a number of production stops in Germany.



TO BE THE EMPLOYER OF CHOICE :

"CONSTANT CHALLENGES IN AN INTERNATIONAL ENVIRONMENT"

One is a qualified psychologist and works in Berlin. The other is an industrial engineer based in Stockholm. But Stefanie Collmann and Diego Klappenbach have a lot more in common than you would think. They are two important members of the team that is going to build up Vattenfall's European business - and they are both spurred on by the international challenges of their jobs.

"I work with our new investments in Denmark, and study how we should integrate the new assets with our own," says Diego Klappenbach, a project developer at the Generation Nordic business unit.

Diego has recently completed the international trainee programme: 12 months theory and practical work in different parts of the Group, such as two months work at Vattenfall Trading Services in Hamburg.

When Diego was selected as a Vattenfall trainee, he was one of the six candidates chosen from 1,300 applicants.

"I was drawn to the opportunity to develop within technology, business administration and leadership, and the job has fulfilled my high expectations," says Diego.

In the future, Diego would like a position that combines these three areas, such as in management. And his chances are good - Vattenfall has four internal leadership development programmes for managers.

Stefanie Collmann at Vattenfall Europe Berlin started working for the Group in 2001 and has climbed a fair way up the career ladder. As a manager in market analysis she is responsible for communication and strategy issues, for instance.

"I completed the Vattenfall Core Management Programme and



found it very informative: Vattenfall's values and visions are no longer just words - I have a deeper understanding of them. I also got the chance to compare challenges and problems with my colleagues in other countries - and widened my network," Stefanie explains.

The past year Stefanie's job has been marked by the extensive branding work: the rebranding from Bewag to Vattenfall. The new name applied as of 1 January 2006.

"But we were working intensively with the branding process throughout 2005. It was a huge task, but extremely interesting and stimulating."

Diego and Stefanie both emphasise the international opportunities and competence development as important reasons for their being so happy at work.

Vattenfall's growth creates development opportunities for the company's employees. And Diego's future goal is clear.

"I would like to work in Central Europe and develop our business there. It would suit me well because I enjoy working with qualified people from other countries and I myself have a multicultural background."

Stefanie also faces many exciting challenges:

"My goal is for Vattenfall to be the strongest brand in the German energy market. And I look forward to working in international constellations in the world of Vattenfall."

To be the employer of choice

Fulfilling the ambition to become a leading European energy company requires Vattenfall to be an attractive employer to both existing and future employees. Within the Group we need good managers and leaders; employees with the right qualification and strong commitment.

Vattenfall has a joint Group process for management planning that aims to identify and develop today's and tomorrow's leaders. The company's managers must have the ability to both lead and develop the business and our employees. Consequently, Vattenfall runs its own internal management development programme in collaboration with leading universities and colleges.

Employees must have the knowledge and skills required to solve their daily tasks - both now and in the future. Vattenfall's process for securing strategic competence ensures access to the know-how we need in a long-term perspective.

Having dedicated employees is decisive to Vattenfall's future development. The annual My Opinion survey allows all employees to express their views of the work situation. The results provide a basis for ongoing dialogues between managers and their staff in which they together develop action plans. In this way, My Opinion leads to the constant development of Vattenfall's organisation and culture.

COMPETENCE DEVELOPMENT CREATES THE REQUISITES FOR PROFITABILITY

One of the most important conditions for Vattenfall to create long-term profitability is the company's ability to attract, develop and retain skilled employees. To ensure this, Vattenfall invests in creating a working environment that develops and encourages top performance.

To be the employer of choice

An attractive employer offers a working environment that attracts, develops and retains competent employees and encourages top performance. To attain long-term profitability Vattenfall must be an attractive employer.

Vattenfall, like the energy sector in general, is facing large numbers of employees reaching retirement age. Parallel to this, the competition to attract new employees is toughening. The technical requisites and market conditions continually change and develop. To secure the necessary competence base, Vattenfall must be an attractive employer to potential as well as existing employees.

Accordingly, within Human Resources we focus on three main strategies:

- Ensure a supply of first class managers and leadership
- Ensure access to the competence that meets our long-term needs
- Ensure strong dedication and commitment among our employees.

Leaders create business and develop employees

At Vattenfall we want our leadership to be characterised by leaders who can work in an international and changing environment. Our managers shall set goals together with their employees, motivate them to feel committed and provide regular and clear feedback. An active management planning process and a joint Group programme for leadership development are important tools in achieving this.

The aim of the management planning process is to secure the succession of and develop managers. At Group level, the 225 highest managerial positions are identified along with potential candidates for these positions and young managerial candidates. In 2005 we assessed 920 employees. Each person has then had the opportunity to discuss their results and future development with their immediate manager. Our

assessment criteria are goal fulfilment, leadership profile in accordance with the Group's leadership criteria, employees' assessments, compliance with Vattenfall's Code of Conduct, language skills and short-term and long-term development potential. The process results have been reviewed with the management of the respective business units and business groups and the Executive Group Management. In 2006, the process will be expanded to include all managers within the Group, with a focus on increasing rotation between units and countries and increasing the proportion of female managers.

The Vattenfall Management Institute is responsible for designing and delivering leadership and management development programmes within those areas that are of strategic importance to the Group. During the year, the newly started network for female managers and leaders held two meetings. In 2005, a total of 340 people took part in the different programmes. In evaluations, the participants awarded an average score of 4.5 out of 5.

2005 also saw all higher level managers and other employees with extensive external contact networks participating in an Antitrust Compliance programme to gain a basic understanding of the antitrust regulations and Vattenfall's Code of Conduct. 500 employees have participated in the course.

Knowledge and experience safeguarded

A joint process for strategic competence planning was implemented throughout the Group during the year. This process is a tool for translating long-term business plans into future competence needs and provides us with the opportunity to proactively secure access to the competence we need. It is clear that prior to the future increase in retiring personnel we must continue to focus on giving existing employees the opportunity to develop within the Group and work to ensure that the competencies held by senior employees remain in the

organisation when they leave. The methods for achieving the latter vary from structured documentation of tacit knowledge and teaming up senior and junior employees to special mentor programmes intended to transfer knowledge. Through a Competence Transfer Mentoring Programme experienced managers and specialists have learnt a special method for communicating their professional skills as well as their work experience to younger colleagues.

In order to provide students with a picture of Vattenfall as an employer, we work with selected schools and universities, offer apprenticeships and internships, provide opportunities to conduct thesis work and so on. As a part of this work Vattenfall's international trainee programme was carried out during the year.

Diversity triggers new ideas

In the long term, our employees must reflect the societies in which we operate. We actively work to increase diversity as regards age, gender and ethnic/cultural background. One example of this is our customer service centre in Berlin, which has staff with knowledge of the languages and cultures required to give our customers with non-German backgrounds good service. The number of cultures represented increases continually.

In Sweden, we started the "Young Graduate" recruitment initiative for the second time. By offering temporary employment contracts, Vattenfall hopes to provide young academics the opportunity to get a foot in the employment market while also providing Vattenfall access to new knowledge. In 2006, 20 new graduates will be given temporary employment. Of the 45 people who participated in the project completed at the beginning of 2005, 23 were female and 12 had non-Swedish backgrounds. 37 have continued their employment at Vattenfall.

Commitment provides the power to become leading

In 2005, the My Opinion employee survey was conducted for the fourth time, but for the first time all business units in the Group took part. The total response frequency was 65 per cent and high response frequencies throughout the organisation show that the

survey is now a well-established tool. For employees the survey is an instrument with which to put forward opinions as to how working conditions could be improved and thereby contribute to the development of Vattenfall's culture. The survey shows that most employees appreciate their work situation and a distinct increase has been seen, especially in Poland and Germany. Compared with previous years, we can also see positive development in the indicators associated with the three strategic Human Resources processes: "Leadership quality" 71% (71%), "Training and development" 70% (69%) and "Commitment" 75% (71%). The percentages are the proportion of positive answers in each category. The "Commitment" category includes questions associated with pride in the company and its culture and values. We can see that employees have become more familiar with what the new Vattenfall stands for and feel proud to be a part of it. Each manager is expected to discuss actions and follow up earlier action plans with her/his team. This year's survey will indicate which improvements have actually been realised.

Healthy employees perform better

Work at Vattenfall shall give opportunities for development in a safe, healthy and stimulating environment. An explicit goal is that no-one should become injured or ill due to their work situation. Accordingly, statistics for occupational injury and absenteeism through sickness are carefully monitored throughout the Group and have long shown low values compared to both the industry and national averages.

In Sweden, our vision is to have Sweden's healthiest workforce and for many years we have been able to report levels of absenteeism through sickness considerably below the national average for Swedish trade and industry. From a level of 4.5 per cent in 2002, absenteeism through sickness has dropped to 4.1 per cent (4.0% in 2004). During the year, for example, joint, occupational health services were procured and activities to promote good health were increased.

Absenteeism through sickness for the year for the Group as a whole was 4.0 per cent and, for the third year running, we can note a decrease in occupational injuries.

ACTIVE CORPORATE GOVERNANCE WITH MARKET TERM REQUIREMENTS

Vattenfall AB, the parent company of the Vattenfall Group, is wholly owned by the Swedish state. The Swedish state exercises long-term active ownership and administration with value creation as a paramount goal. State companies exposed to competition shall operate under the same requirements and terms as other market players. This means that the owner places market requirements on profit and returns, based on the state-owned companies' risk profiles.

Vattenfall AB falls under the same legislation as private Swedish companies and where applicable Vattenfall follows the recommendations and norms that apply to companies listed on the Stockholm Stock Exchange. The Swedish Code for Corporate Governance (the Code) is a part of the Swedish government's framework for ownership and administration. Vattenfall applies the Code and considers it one of several important sets of rules for external reporting and communication.

Basis of corporate governance

The shareholder's influence over the company is practiced at the annual general meeting, which is the highest decision-making body in the company. The Swedish government encourages the state companies to hold open annual general meetings to offer the public the opportunity to attend and, in conjunction with the meeting, pose questions directly at company management.

The articles of association stipulate the framework for Vattenfall's operations. At the annual general meeting in 2005 an addition was made to the articles of association stating that "the Company shall, within the framework of businesslike operations, be the leading company in the transition to an ecologically and economically sustainable Swedish energy supply". The owner provides the background and motivation of this addition. The motivation was included as an appendix to the minutes of the annual general meeting. Vattenfall's efforts within renewable energy are described on pages 26–29 of the Annual Report. The Swedish government has established a separate division for state enterprises within the Swedish Ministry for Industry, Employment and Communications which, like other owners, works with a number of important tools, such as:

- The composition of the Board of Directors (see the presentation of the Board on page 58)
- Auditors (see the presentation of the auditors on page 56 and the Audit Report in the Annual Report on page 112)
- Transparency (see the Board's report on internal control on page 57).

In order to clarify the Swedish state's view on certain issues, and to attain unity among the administered companies, the Swedish government has established guidelines for external financial reporting, terms of employment for senior management, and terms for employee incentive programmes. In addition, the Swedish government has identified certain crucial policy issues in which companies owned by the state shall act in a socially responsible manner. This applies to such areas as equality, the environment, diversity, the working environment and the company's role in society.

In order to promote clarity and unity in questions of responsibility and information in the state companies, the Swedish Ministry for Industry, Employment and Communications has prepared guidelines to support boards of directors in drawing up and revising the rules of procedure and for managing certain issues regarding information.

Management and control of the Vattenfall Group is divided between Vattenfall AB's shareholder, the Board of Directors and the CEO in accordance with the Swedish Companies Act, the Articles of Association and the Board of Directors' Rules of Procedure. The

Board of Directors appoints a CEO and deputies. The CEO manages and is responsible for day-to-day administration in accordance with the Board of Directors' guidelines and instructions.

Responsibility and decisions within the organisation

Vattenfall's President, who is also the CEO of Vattenfall AB (the CEO) is responsible for the Group's day-to-day operations.

The CEO has established two decision forums to manage the Group, Executive Group Management (EGM) and the Executive Committee (ExCom). The CEO passes decision with or without the support of these forums. ExCom handles central joint Group issues such as Vattenfall's strategy, major acquisitions, investments and divestments.

EGM develops the Group's general direction, Group policies and Group instructions. Group processes are approved, as are Group initiatives and projects, on the recommendations of Group functions.

In order to follow up on financial and business developments in the Group, the CEO and EGM hold thorough quarterly Business Group Reviews and monthly Business Group Financial Meetings.

Managing operations and making decisions

General information about the Group's management system

The Group is governed with a focus on value creation and long-term overall goals and requirements for the Business Units and Business Groups. The Business Groups propose short-term goals for each Business Unit, which are subsequently approved by the CEO and EGM.

In order to ensure that Vattenfall develops in the intended direction and lives up to ethical and legal requirements, the CEO has established the Group Management System (GMS). The GMS also comprises a description of how the Group is governed. The GMS is available to all employees and amendments are continually made and published on the Group's intranet.

The management system consists of a number of building blocks (see the management system illustration on page 52). The management system is based on Vattenfall's mission and vision, joint Group codes of conduct and company philosophy, "Code of Conduct" and Group policies within important areas.

The instruction "Roles and Division of Responsibility" defines general decision forums and fundamental roles in the Group's management system.

"Principles for decision-making and delegation", concerning delegation from the Board to the CEO and from the CEO to the Business Group managers and Group function managers, is another important instruction.

The Group's management processes for strategic planning, business planning and following up are essential management tools for Executive Group Management.

The Group functions are responsible for proposing, developing and following up Group policies and Group instructions. The Group has a quality department charged with coordinating the management system. The Group's quality manager and environmental manager must approve all Group policies and Group instructions before they are officially adopted. Executive Group Management approves all governing documents.

From the Chairman

Dear Reader,

State-owned limited liability companies are independent corporate entities subject to the Swedish Companies Act. This legislation has been developed for companies operating in order to make profits. In a limited liability company, there are clear divisions of responsibility between the owners, the board and company management, as well as rules governing how this responsibility is expected to be exercised.

State ownership means that Vattenfall operates in not just a public but also a political arena - with the associated lively discussions about the company's undertakings. Ultimately, it is the Swedish people that own the company, represented by the Swedish Parliament. Responsibility for managing this interest is exercised by the Swedish Parliament, acting through the Swedish Ministry of Industry, Employment and Communications.

Vattenfall's transformation from a public service enterprise to a limited liability company, which took place on 1 January 1992, was preceded by thorough deliberations in the Swedish Parliament. The bills (1990/91:87 on economic policy and 1991/92:49 on issues in the transformation of the state Water Power Board to a limited liability company) explicitly address the incorporation of Vattenfall, corporate governance issues and more. In the course of its debate, the committee stated that:

"It is emphasised (in the bill) that it is the task of the company's board to establish goals and strategies for Vattenfall's operations. If Vattenfall is to conduct its business in a reasonable manner and without competitive disadvantages, its board and executive group management must be given the opportunity to have control over the company's resources on the same terms as are prevalent in the non-governmental business sector."

According to the view of the committee it is important that the Swedish electricity market be opened to increased and more effective competition. Vattenfall AB must be provided such conditions as to enable the company to develop and adapt to the forthcoming changes in the electricity market. As stated in the bill, the company ought to be able to dispose of its resources under the same terms and conditions that apply to privately-owned power companies. The committee therefore supports the bill's proposal that guidelines for operations in the new company should not be subject to parliamentary approval.

This does not mean, however, that parliamentary supervision of the company ought to cease. As long as the state is the majority owner, information on the company's operations shall be submitted to parliament through the annual reporting procedures for state-owned companies. Motions may be proposed as a result of the content of this reporting.

As a result, Vattenfall's Board has a great responsibility. Different demands must be weighed up. The operational framework and guidelines provided by the Board shall be in accordance with applicable legislation and the owner's requirements. At the same time, the owner's ambitions regarding the development of new electricity generation techniques, renewable energy sources, frugal electricity consumption and so on shall be taken into consideration. Reliable deliveries at reasonable prices must also be provided. All of these demands must be met in a manner that is justifiable in the long-term. In doing so, we also ensure the best outcome for both the company and society.

At last year's annual general meeting, an addition was made to the Articles of Association:



"Vattenfall shall, within the framework of businesslike operations, be the leading company in the transition to an ecologically and economically sustainable Swedish energy supply."

This amendment supports Vattenfall's ambition to be a pioneer and drive development forward. Vattenfall's development in recent years, which has combined considerably larger volumes with sharply increased profitability, creates a strong resource base for future-oriented investments. An action plan for Vattenfall's work with renewable energy in the Nordic countries has been adopted together with routines for regular reports to the Board. This plan includes a number of both smaller and larger projects, covering electricity as well as heat. If and when the projects can be implemented depends on the required assets being acquired, permits being issued, stable support systems being in place and the necessary machines and equipment being available at reasonable costs.

That state-owned companies have open and professional information channels is a question of democracy, as ultimately these companies are owned by the Swedish people. In addition to the Annual Report, each year Vattenfall publishes a Corporate Social Responsibility Report and an Electricity Market Report. The general public are now invited to participate in the annual general meeting (AGM). Vattenfall applies the new Swedish Code for Corporate Governance 2005. The main aim of the Code is to ensure transparency and insight for all owners of listed companies. In those cases where we deviate from the guidelines it is due to the fact that the state is the sole owner.

Dag Klackenberg

Dag Klackenberg
Chairman of the Board

All Vattenfall employees are obliged to follow the management system's governing documents for operations. Each Business Group has its own management system adapted to its particular requirements. The Group's auditing function is responsible for ensuring that the Group Management System is followed.

Organisation and processes

Vattenfall's organisation model is based on the value chain for electricity: generation, transmission, distribution and sales and for heat generation, distribution and sales. The CEO heads the Group's business operations and administration in accordance with the Swedish Companies Act and the Board's instructions. Operations are conducted with full transparency in accounting, control, profitability and value creation.

In terms of management Vattenfall's operations are divided into three categories:

- Business operations are handled by Business Groups and their Business Units within defined geographic areas. They are managed as profit centres.
- Group functions that support Executive Group Management, Business Groups and Business Units. They are managed as cost centres.
- Shared Service units which provide services that support customer efforts to optimise their business operations. Shared Service activities are run on a full cost basis and are managed by the internal customers. Shared Service units are found at both Group level (Group Shared Services) and Business Group level.

A number of management processes essential to the Group have been established. Each process is managed by a process owner,

usually a member of EGM, who is responsible for developing the process. At present, the following Group processes exist:

Process	Process owner
Strategy and business planning	Head of Group Strategies
Reporting and following up	Chief Financial Officer
Risk management	Chief Financial Officer
Merger & Acquisitions	Head of Legal Affairs and M&A
Investments	Chief Financial Officer
Communications	Head of Communications
Management development	Head of Human Resources
Capacity management	Head of Capacity Management

The most important Group process is Strategy and Business Planning, which results in the annual strategy and business plans. This process includes the analysis, and assessment of strategic issues for ongoing evaluation with decisions on selection, formulation and prioritisation made by EGM. Strategy planning includes the Group's long-term operations as well as its financial performance.

Each year a five-year Strategic plan is decided by Vattenfall's Board.

Based on the directives of the Strategic plan, the Business Groups and Business Units draw up three-year business plans that are approved by ExCom and adopted by the Board on an annual basis.

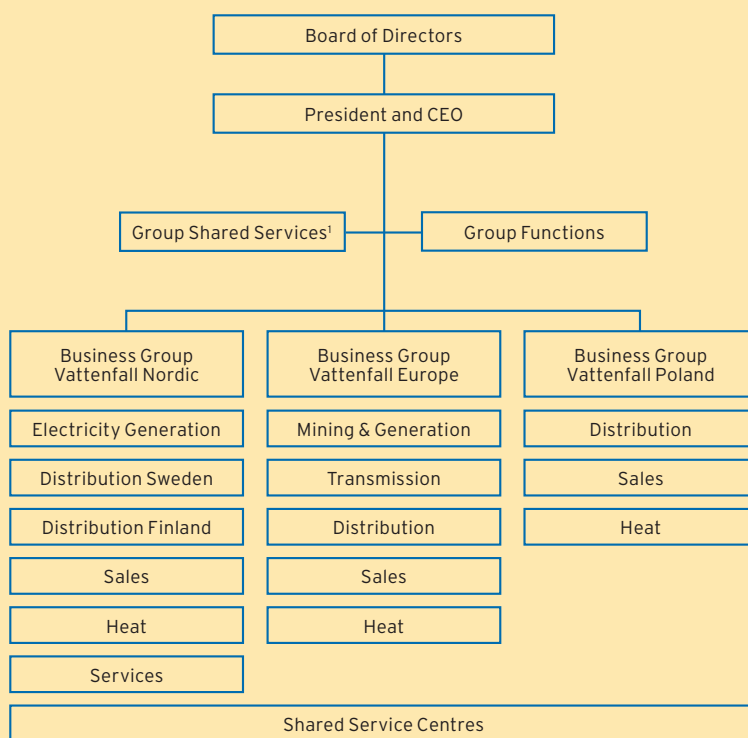
Governing business ethics

Vattenfall's core values are:

Openness, Effectiveness and Accountability.

Vattenfall's organisation

Management system building blocks



1) Vattenfall Trading Services, Vattenfall Treasury, Vattenfall Insurance and Vattenfall Utveckling AB (research and development).

Deviations from the Code

Vattenfall's governance deviates from the following requirements of the Code:

Code requirement	Description	Comments
1.4.4 The role of the chairman of the board	Issues at the annual general meeting	Technically speaking this is fulfilled. At the annual general meeting 2005 Vattenfall organised a question and answer session to the public. In addition, members of the Swedish parliament have the right to ask questions at the annual general meeting.
2.1.1 Nomination committee	Nomination committee criteria	Information on the nomination process can be found on Vattenfall's website. Vattenfall follows the Swedish state's ownership and administration policy.
2.1.1 Nomination committee composition	At least three persons	Information on the nomination process can be found on Vattenfall's website. Vattenfall follows the Swedish state's ownership and administration policy.
2.2.1 Nomination committee proposals for board members and remuneration	The nomination committee's proposals for board members, chairman of the board and allocation of remuneration	Proposals included in the notice of AGM
2.2.2 Basis of nomination committee proposals	The nomination committee draws up profiles based on required qualification	Information on the nomination process can be found on Vattenfall's website. Vattenfall follows the Swedish state's ownership and administration policy.
2.2.4 Presentation of nomination committee proposals at the annual general meeting	Motivation for re-election and how the work has been conducted	Will be followed for the annual general meeting 2006.
3.8.4 Board meetings with the auditors	The board shall meet with the auditors at least once a year without company management's presence	No separate meeting during 2005.
4.2.1 Remuneration committee	There is no remuneration committee.	Working party to be appointed when needed.
4.2.2 Principles for senior management remuneration	Remuneration principles are approved by the annual general meeting	The Board forms a working group as necessary.
4.2.3 Share and share price related incentive programmes	To be decided by the annual general meeting	Not applicable. Vattenfall is not listed on the stock exchange.

In 2005 the Board approved Vattenfall's joint Group "Code of Conduct", which stipulates that all employees shall follow and work in accordance with Vattenfall's core values, policies and Group instructions. (For further information, see Vattenfall's Corporate Social Responsibility (CSR) report which can be downloaded and ordered from www.vattenfall.com).

Application of the Code and the contents of the Corporate Governance Report

Vattenfall applies the Code and considers it one of several important sets of governing regulations for external reporting and communication. Information relevant to corporate governance is reported as references to the applicable information if it is already available in the annual report.

The work to introduce the Code in the Group's work began in conjunction with the preparations for the 2005 annual general meeting, held on 26 April. Information, agenda, notices and reporting were adapted as far as possible to fulfil the requirements of the Code. Since August 2005, the personnel concerned have been informed and trained in order to increase understanding of the Code and its practical application. The work with the corporate governance report and the report on internal control began in September 2005.

The Board's composition and work

Work allocation in the Board

The Chairman's duties follow both the Swedish Companies Act and the Rules of Procedure. The Chairman heads the work of the Board and is responsible for ensuring that other Board Members receive adequate information. The Chairman participates when necessary in important external contacts.

The Board establishes its Rules of Procedure annually, based on the supporting documents for rules of procedure in state companies which the Swedish Division for State Enterprises of the Ministry for Industry, Employment and Communications has issued. The Rules of Procedure regulate such things as the Chairman's duties, information to the Board and the frequency and form of Board Meetings, as well as evaluation of the work of the Board and the CEO.

Matters dealt with by the Board are primarily treated in accordance with the Swedish Companies Act and the Board's Rules of Procedure. The main tasks of the Board, apart from appointing a CEO and deputies, are to establish the strategic direction of operations, approve major investments and substantial organisational changes in the Group, and to establish central policies and instructions. In addition, the Board shall follow the company's financial development and has ultimate responsibility for internal control and risk management.

The Board's risk management process

Operative risk management is regulated by Group instructions with a special focus on risks within energy & commodity trading and financial, insurance and credit risks. The Board decides on overall risk limits for the Group within all these areas. The operative risks are regularly followed up and reported within each Business Group. At each meeting the Board is informed about the Group's financial position and any outstanding guarantees and risks are reported. Twice a year the results of earlier decisions on investments are reported for following up. The Board also holds an annual risk management seminar with a more thorough review of the Group's financial and operational risks.

The Chief Financial Officer (CFO) has the overall responsibility for financial activities and risk management in the Group and ensures that the company's policies and instructions are followed. A Group risk committee has been established in order to support the CFO in these issues with the primary task of ensuring qualitative risk management in the Group by, for example, approving methods for risk handling, ensuring standardised routines for risk management and risk reporting and to propose mandates and limits. Since 2003, the Group conducts an annual environmental risk evaluation coordinated by the Group's environmental manager. The result is presented to Executive Group Management and Vattenfall's risk management committee. A long-term goal is to combine environmental risk management with existing risk management. For more information about Vattenfall's risks and risk management, see pages 60–63 in the Annual Report and Note 35 of the consolidated accounts.

Composition of the Board

Vattenfall's Board consists of eight Board Members appointed at the Annual General Meeting, and three Board Members and three Deputy Board Members appointed by the employee organisations. From company management, the CEO, Lars G Josefsson, is included. Of the Board Members, two are women, both foreign citizens. The average age of the board members is 53.

At the annual general meeting in 2005 Maarit Aarni, Christer Bådholm, Lars G Josefsson, Dag Klackenberg, Peter Lindell, Hans-Olof Olsson, Lone Fønss Schrøder and Anders Sundström were elected Board members. The annual general meeting appointed Dag Klackenberg Chairman of the Board. The employee organisations have appointed Board Members Carl-Gustaf Angelin, Johnny Bernhardsson, Ronny Ekwall and Deputy Board Members Lars Carlsson, Stig Lindberg and Per-Ove Lööv.

Board remuneration

Board remuneration is decided by the annual general meeting. The CEO does not receive remuneration for Board work. For information about Board remuneration for 2005, see the Annual Report for 2005, Note 45 of the consolidated accounts.

Board independence

As regards independence in relation to the owner, the Swedish state's ownership policy stipulates that nominations to the Board must be made public in accordance with the guidelines of the Code. The only deviation is that the independence in relation to major

shareholders is not reported. Of the Board members, Dag Klackenberg, Maarit Aarni, Christer Bådholm, Peder Lindell, Hans-Olof Olsson, Lone Fønss Schrøder and Anders Sundström are independent in relation to the company.

Appointing the Board

The offprint "The Swedish Government's Ownership and Administration" specifies the principles for the appointment of board members and auditors in wholly-owned state companies that replace the corresponding regulations of the Code. The Swedish Minister of Employment, Industry, and Communication has been assigned responsibility for board nominations in state-owned companies. The nomination process is run and coordinated by the Division for State Enterprises within the Swedish Ministry for Industry, Employment and Communications. A working party analyses qualification needs based on the board's composition, the company's operations and the current situation. Thereafter, if recruitment needs exist, recruitment work is initiated. The selection of board members is chosen from a broad recruitment base. Nominations are made public in accordance with the Code's guidelines.

Description of the Board's work

Board Meetings follow a plan established in the Rules of Procedure. These rules specify that seven ordinary meetings shall be held each year. In addition to the ordinary meetings, the Board is summoned to further meetings if the need arises. According to the Rules of Procedure, one meeting per year must be held at a place other than the head office. In 2005, a meeting was held in Hamburg during which the Board visited local plants and was provided with in-depth information about the Group's activities in Germany as well as on local and national German politics.

The Rules of Procedure stipulate that the following items must be included on the agenda once a year:

- The Group's Strategy
- The Group's overall risk exposure
- Safety and environmental issues within nuclear power
- Personnel issues within the Group, including opportunities to attract and retain qualified staff
- Research and development costs within the Group

The following are also reported at each meeting:

- Important business events since the previous meeting, under the item "State of Business"
- The Group's financial position.

Investments are followed up and analysed by the Board three years after the Board's decision to invest. The Board also holds a number of board seminars each year. At these seminars the Board receives more detailed information about and discusses Vattenfall's long-term development, strategy, competition and risk management.

During 2005, the Board met nine times, including the statutory meeting. The following is a review of the meetings, touching on some of the important issues covered.

Issues covered by the Board appointed by the 2004 annual general meeting

Date of meeting	Focus and important issues covered
Extra board meeting, 12 January 2005	• M&A issue
Board meeting 17 February 2005	• Evaluation of the work of the Board and CEO • Annual accounts, annual report and audit report • Vattenfall's R&D activities • Management Planning and Development • Update on hurricane "Gudrun" • M & A update – status report
Board meeting, 25 April 2005	• Vattenfall's three-month interim report
Statutory board meeting, 26 April 2005	• Amended articles of association • M&A issue

Issues covered by the Board appointed by the 2005 annual general meeting

Date of meeting	Focus and important issues covered
Board meeting, 13 May 2005	• Amended articles of association and "Renewable Energy" plan • Code of Conduct & Company Philosophy • Negotiations on the premature closing of Barsebäck 2 • Kriegers Flak wind power project
Board meeting, 27 July 2005	• Vattenfall's six-month interim report
Board meeting, 31 August 2005	• Barsebäck 2, negotiations on premature closing • Plan for continued work with "Renewable Energy" • Follow-up of investments made during the first six months of 2005 • Competitor analysis • Strategic plan
Board meeting, 26 October 2005	• "Renewable Energy" plan • Vattenfall's nine-month interim report
Board meeting, 8 December 2005	• Approval of the agreements concerning the closing of Barsebäck 2 • Annual follow-up of the investment programme within hydro and nuclear power in the Nordic countries • Report on the "Renewable Energy" plan • Approval of business plans and investment budget • Changed discount factors for provisions • New environmental policy

	The Board appointed by the 2004 annual general meeting			The Board appointed by the 2005 annual general meeting					
	050112	050217	050425	050426	050513	050727	050831	051026	051208
Maarit Aarni	X	X	X	–	X	X	X	X	X
Christer Bådholm	X	X	X	X	X	–	X	X	X
Lars G Josefsson	X	X	X	X	X	X	X	X	X
Dag Klackenber	X	X	X	X	X	X	X	X	X
Peter Lindell	X	X	X	X	X	X	X	X	X
Hans-Olov Olsson	–	–	–	X	X	X	X	X	X
Lone Fønss Schrøder	X	–	X	X	X	X	X	X	–
Anders Sundström	X	X	X	X	X	X	–	–	X
Carl-Gustaf Angelin	X	X	X	X	X	–	X	X	X
Johnny Bernhardsson	X	X	X	X	X	X	X	X	X
Ronny Ekwall	X	X	X	X	X	–	X	X	X
Jan Grönlund	–	X	–						
Lars Carlsson*	X	–	X	X	–	X	–	X	X
Stig Lindberg*	–	X	X	X	X	–	X	X	X
Per-Ove Lööv*	X	X	X	X	X	X	X	X	X

X Present – Not present

*) Deputies

Evaluation of the Board's work

The Board evaluates the work of the Board of Directors once a year. This evaluation is headed by the Chairman and reported to the Board. The results for the Board's work in 2005 have not yet been reported.

Committees

Audit Committee

The Audit Committee is a committee established within the Board in order to increase knowledge of, insight into and control over the company's accounting, financial reporting and risk management. The Audit Committee is responsible for work with the Code's application and for preparing the specified reports. In conjunction with audits the company auditors have reported their observations at Audit Committee meetings. No formal mandate to pass decisions has been delegated to the committee as the committee is comprised of Board members.

In 2005, the Board appointed the following three persons members of the Audit Committee: Peter Lindell, Christer Bådholm and Lone Fønss Schrøder. Deputy Board Member Per-Ove Lööv participated in the Audit Committee as an employee representative. Internal audits at Vattenfall are headed by the secretary of the Audit Committee. For details concerning remuneration to committee members, see Note 45 of the consolidated accounts in the annual report.

The Audit Committee prepares the Board's work to safeguard a high quality in the company's financial reporting.

The Board has established rules of procedure for the Committee. The Committee reports its work to the Board by submitting the minutes to the Board and, when requested, by presenting its work at Board Meetings

The Audit Committee held four meetings in 2005. The auditors were present at all meetings to present their observations from the audit of the annual accounts and the summary review of the six-month accounts. The auditors presented their audit of the annual accounts to the entire Board at the Board Meeting held on 17 February 2005.

The following table exhibits each member's attendance at the Audit Committee meetings:

Members present at Audit Committee meetings in 2005

	050214	050510	050829	051205
Peter Lindell	X	X	X	X
Christer Bådholm	X	X	X	X
Lone Fønss Schrøder	–	X	X	–
Per-Ove Lööv (employee representative)	X	X	X	X

Nomination Committee

There is no nomination committee at Vattenfall AB. See the section "Appointing the Board" on page 54 for more information about appointing the Board.

Remuneration Committee

There is no remuneration committee at Vattenfall AB.

Remuneration to executive management

The Board has approved a programme in accordance with the Swedish government's new guidelines on remuneration and incentive programmes for executive management. The programme encompasses all employees in Sweden and applies as of 2005. Each year an internal audit is conducted to check that these guidelines are followed. The result of the audit is presented to the Board.

In line with the guidelines, the CEO no longer receives any variable salary. Other managers and employees do not have higher variable salaries than the equivalent of two monthly salaries a year, or 16.7% of the normal fixed salary. As before, the basis of the incentive programmes continues to be the Group's long-term value creation. Common to all is the Group's targets. Further, the performance of each unit and individual is measured.

Additional information about taxable remuneration, benefits and pension costs for Board Members, the CEO and other executive management can be found in Note 45 of the consolidated accounts in the Annual Report.

Safeguarding the quality of financial reporting

The Board has presented the structure of the internal control process within the financial reporting routines in the special report on internal control (see page 57).

The work in the Audit Committee comprises a part of this control exercised by the Board, with external and internal auditors presenting their observations to the Board members of the Audit Committee. The external auditors presented their observations concerning the six-month and annual accounts at each Audit Committee meeting in 2005. At these meetings Vattenfall's internal auditing is represented by the unit's manager, who also presents the unit's findings to the Audit Committee. At least two meetings between all Board members and the external auditors are planned for 2006.

In conjunction with planning work for the annual audit, discussions are underway between the external auditors and the internal auditing unit concerning Vattenfall's risk situation.

Auditors

The 2004 annual general meeting appointed auditing firm Ernst & Young AB as auditors with authorised public accountant Lars Träff as auditor-in-charge. The appointment runs until the annual general meeting 2008. In addition to Vattenfall, Lars Träff holds auditing assignments for, among other companies, Esselte, FöreningsSparbanken, JM, Observer, Ticket and TV4. Lars Träff has no assignments for companies that would influence his independence as Vattenfall's auditor.

The Swedish National Audit Office appointed authorised public accountant Per Redemo until the annual general meeting 2008. Per Redemo is appointed auditor for the following companies: Vattenfall AB, Green Cargo AB, Swedish Broadcasting Corporation (Sveriges Radio AB) and Swedish Educational Broadcasting Company (Sveriges Utbildningsradio AB). Per Redemo is also auditor-in-charge for the following authorities/public service utilities: Swedish Tax Agency (Skatteverket), Swedish Central Student Grants Committee (CSN), Swedish Financial Supervisory Authority (Finansinspektionen) and Swedish State Railways (Statens Järnvägar). Per Redemo has no assignments for companies that would influence his independence as Vattenfall's auditor.

The auditors are present and report at Board meeting concerning the annual report and meet with Vattenfall's CEO and CFO on a number of occasions throughout the year. In addition, the auditors have ongoing contact and meetings with the Board's Audit Committee. When more extensive consultancy input is required from the elected auditors, the assignment shall first be examined and approved by the Audit Committee. The Group's audit costs are described in more detail in Note 48 of the consolidated accounts and Note 37 of the parent company accounts in the Annual Report.

Consultations with Ernst & Young AB during 2003–2005 chiefly concerned tax proceedings, issues affecting expatriate employees, and in 2005, issues concerning the transition to reporting in accordance with IFRS.

Audit of the Corporate Governance Report

This Corporate Governance Report has not been audited by the company's auditors.

THE BOARD'S REPORT ON INTERNAL CONTROL FOR THE 2005 FINANCIAL YEAR

This report on internal control concerning the Vattenfall Group's financial reporting has been prepared in accordance with sections 3.7.2 and 3.7.3 of the Swedish Code for Corporate Governance (the Code). The report follows COSO's* framework for internal control and encompasses control environment, risk assessment, control activities, information and communication and monitoring.

Description

Control environment

The framework surrounding the Board is comprised of, in addition to applicable legislation, the Swedish state's ownership and administration policy and the Code. The control environment comprises the foundation for internal control at Vattenfall and includes, among other things, the company culture. In 2005, the Board approved Vattenfall's joint Group Code of Conduct, which expresses the expectation that all employees agree to follow Vattenfall's company philosophy, codes of conduct, core values, policies and rules.

The formal division of authority in the Group is based on the division of responsibility between the Board and the CEO established by the Board in the Rules of Procedure. The Group's management system is decided by the Board of Vattenfall AB and includes, among other things, Group instructions for decision making, delegation and authorisation, management of subsidiaries, risk management and internal control. The rules governing and the outcome of the Group's risk assessment and risk management process are reviewed by the Board each year. The accounting and reporting instructions are documented separately.

The Board has appointed an Audit Committee assigned with the task of, among other things, assessing the scope and direction of the Group's risk management. The Committee also reviews the auditors' opinions on the Group's financial reporting and initiates any follow ups deemed necessary.

Risk identification and risk management

The Board has given Vattenfall's management a risk mandate, which in turn has delegated this to Vattenfall's units in accordance with a delegation structure. Unit results are continually followed up and reported to executive management by Vattenfall's risk control function, which is also responsible for the supervision of the Group's overall risk mandate. The risk control function is also responsible for mapping out risks in the organisation and developing appropriate models and measurement methods for managing these risks. The Group's risk management and reporting is coordinated by a Risk Committee headed by Vattenfall's Chief Financial Officer. The Risk Committee's task is to scrutinise policies and mandates and to approve the risk instructions and risk models applied within the Group. The utilization of risk mandates is reported and presented at each Board meeting.

Control activities

In addition to auditing the annual accounts, Vattenfall's auditors also review the six-month accounts. The proposed report is presented to the Audit Committee along with the opinions provided by Vattenfall's external auditors.

Throughout the last financial year the Group conducted special controls concerning IFRS requirements.

Each Business Group and Business Unit has controllers who, among other things, are responsible for ensuring that appropriate internal control routines exist, Group control processes are implemented and any risk exposure is reported. Special controllers also exist within the areas of communication, risk management and IT. There is a limited group of signatories authorised to sign on behalf of the company.

Information and communication

Executive Group Management's internal communication channels mainly consist of the intranet and management conferences, together with regular follow-up meetings with each Business Group. Information and discussions about issues concerning internal control are held regularly by the Audit Committee. The minutes from Committee meetings are submitted to Vattenfall's Board.

Management and following up

Financial follow-ups are conducted monthly through Business Group Financial Reviews, preceded by detailed controller meetings.

Vattenfall's internal audit unit is charged with a number of tasks, including participation in the review of internal control for financial reporting. Important observations are reported to the Audit Committee.

The Board receives monthly financial reports and the financial positions of the parent company and the Group are reviewed at each Board meeting.

All legal units provide monthly and quarterly reports in accordance with standardised reporting routines. In addition to the consolidated accounts for the Vattenfall Group, information is also prepared to enable profitability and different Key Performance Indicators to be measured at Business Area and Business Unit level.

Statement

The Swedish Corporate Governance Board has decided that the board of a limited liability company following the Code for 2005 need not make a statement on how well the control process has worked as the reports for 2005 are not reviewed by auditors. The Board of Vattenfall AB considers the internal control for financial reporting to be organised in an appropriate manner. In 2006, the Board plans to introduce a process to allow an annual evaluation of how internal control works.

Stockholm, 22 February 2006

Board of Directors

*) COSO – abbreviation of The Committee of Sponsoring Organizations of the Treadway Commission

Vattenfall's organisation: Board of Directors



Dag Klackenborg
Chairman



Maarit Aarni



Carl-Gustaf Angelin
Employee board member



Johnny Bernhardsson
Employee board member



Christer Bådholm



Lars Carlsson
Employee board member



Ronny Ekwall
Employee board member



Lars G Josefsson



Stig Lindberg
Employee board member



Peter Lindell



Per-Ove Lööv
Employee board member



Hans-Olov Olsson



Lone Fønss Schrøder



Anders Sundström

Dag Klackenborg Born 1948
Chairman of the Board since 2001
Education: MBA, Stockholm School of Economics, Bachelor of Law, Stockholm University.
Work Experience: Ministry for Foreign Affairs, Trainee (74), various positions (74–93) and finally Director – General for Administrative Affairs (93–01), President of the Swedish Federation of Trade (01–).
Board Member: Chairman of the board of Handelsbanken Regionbank Mellansverige. Board member of LjungbergGruppen AB.

Maarit Aarni Born 1953
Board Member since 2003
Education: MSc (Tech. Chem.) and MBA, Helsinki University of Technology.
Work Experience: Various positions within the Borealis Group (77–01).
Board Member: Member of the boards of Borealis Polymers Oy Finland and Rautaruukki Oy in Finland.

Carl-Gustaf Angelin Born 1951
Board Member since 2003
Education: MSc (Civ. Eng.), Royal Institute of Technology, Stockholm.
Work Experience: Various positions at AB Svenska Fläktfabriken (77–88). Various positions at Vattenfall AB (88–).
Board Member: Employee board member (CF).

Johnny Bernhardsson Born 1952
Board Member since 1995
Education: Qualified engineer, supplementary course in economics, TBV.
Work Experience: Various positions at Vattenfall AB (70–).
Board Member: Employee board member (Sif).

Christer Bådholm Born 1943
Board Member since 2002
Education: MSc (Civ. Eng.), Chalmers University of Technology, Corporate and Group Management, IFL, International Management, MiL.
Work Experience: Various positions at AB Armerad Betong (68–71), Göteborgs Betongpålar AB, various positions and partner (72–74, 77–85), Balken Piling Ltd. UK, Managing Director (74–77), ABV, Managing Director, Region South (87–88), NCC Intl AB, Managing Director (89–91), ABB Traktion AB, Västerås, Managing Director (91–95), Adtrans GmbH, Berlin, Executive Vice President (96–01), Bombardier Transportation GmbH, Senior Vice President, Sales, (01–02), Own consultancy business, (02–).
Board Member: Member of the boards of Green Cargo AB, Metronet Rail Ltd. UK., Icomera AB. Chairman of the board of Bombardier Transportation Sweden AB.

Lars Carlsson Born 1951
Alternate Board Member since 1991
Education: Engineering, Katrineholm Technical College.
Work Experience: Various positions at Vattenfall AB (72–).
Board Member: Employee board member (Sif).

Ronny Ekwall Born 1953
Board Member since 1999
Education: Electrician, Stora Kopparberg Vocational College.
Work Experience: Stora Kopparberg, principal electrician (69–77), Vattenfall AB, electrician (77–).
Board Member: Employee board member (SEKO).

Lars G Josefsson Born 1950
Board Member since 2001. President and Chief Executive Officer of Vattenfall AB.
See page 59, Executive Group Management.

Stig Lindberg Born 1946
Alternate Board Member since 1998
Education: Technical engineering.
Work Experience: Various positions at Vattenfall (67–68), Kraftbyggarna Entreprenad AB, supervisor (88–95), Ringhals AB, supervisor (95–05), Vattenfall AB, fulltime union representative (87–).
Board Member: Employee board member (Ledarna).

Peter Lindell Born 1972
Board Member since 2002
Education: MA (Pol. Sci.), Lund University, Diploma of Economics, London School of Economics.
Work Experience: Journalist, Bloombergs, (98–00), Ministry for Industry, Employment and Communications, Analyst, company administrator for Vattenfall AB, SOS Alarm Sverige AB, AB Svensk Bilprovning (00–).
Board Member: Member of the boards of SOS Alarm Sverige AB and AB Svensk Bilprovning.

Per-Ove Lööv Born 1961
Alternate Board Member since 1999
Education: Business economics, Luleå University of Technology, Engineering, Midskogsskolan Luleå.
Work Experience: Various positions at Vattenfall AB (87–).
Board Member: Employee board member (SEKO).

Hans-Olov Olsson Born 1941
Board Member since 2004
Education: MSc (Pol. Sci.), Göteborg University, Information Management, School of Business, Economics and Law, Göteborg University.
Work Experience: Various positions at Volvo Lastvagnar AB (66–74), Volvo Car Corp. USA, Project Manager (74–77), Volvo Dalslandsverken, General Manager (77–81), various managerial positions in marketing and sales, Volvo Group (81–89), Volvo Cars Japan, President (90–96), Volvo European Sales, Senior Vice President

(96–98), Volvo Market Area Europe, President (96–98), Volvo Cars North America, President & CEO (98–00), Volvo Personvagnar AB, Senior Vice President (98–00), Volvo Personvagnar AB, President & CEO (00–05), Ford Motor Company, Senior Vice President – Chief Marketing Officer (05–).
Board Member: Chairman of the board of Volvo Personvagnar AB.

Lone Fønss Schrøder Born 1960
Board Member since 2003
Education: M.Sc. (Law), University of Copenhagen, M.sc. (Economics), Copenhagen Business School.
Work Experience: Various positions at A.P. Møller-Maersk A/S (82–02), Wallenius Lines AB Sweden, Managing Director (03–).
Board Member: Member of the boards of DSB, Yara ASA, chair of the board of Bioneer A/S, deputy chair of the board of Aker ASA.

Anders Sundström Born 1952
Board Member since 2004
Education: BA (Soc. Sci.), Umeå University.
Work Experience: Piteå Municipality, municipal commissioner (80–94), Swedish Social Democratic Party in Norrbotten, Chairman (89–99), Swedish Social Democratic Party, party executive, and executive committee (90–05), Minister of Labour (94–96), Minister of Industry, Employment and Communications (96–98), Minister of Health and Social Affairs (98), member of parliament (94–98, 02–04), Sparbanken Nord, Managing Director (99–02), Folksam Liv och Folksam Sak, Managing Director (02–).
Board Member: Chairman of Luleå University of Technology, member of the boards of Boliden AB, Falck A/S.



Lars G Josefsson



Matts P Ekman



Klaus Rauscher



Hans von Uthmann



Lennart Billfalk



Ann-Charlotte Dahlström



Mats Fagerlund



Tuomo Hatakka



Knut Leman



Alf Lindfors

Lars G Josefsson Born 1950
President and Chief Executive Officer since 2000
Education: MSc (Civ. Eng), Chalmers University of Technology, Gothenburg (73).
Work Experience: Ericsson, Systems Engineer (74–84), Chemtronics, MD (84–85), Ericsson, Head of Radar Section (85–87), Ericsson Radio System, Deputy Managing Director and Head of Surface Sensor Division (87–93), Schrack Telecom AG, Vienna, MD (93–97), Celsius, MD (97–00).
Board Member: Böhler-Uddeholm AG, IVA Näringslivsråd, Chairman of ESKOM Holdings Ltd, Chairman of German-Swedish Chamber of Commerce.

Matts P Ekman Born 1946
First Senior Executive Vice President and Chief Financial Officer since 2000.
Education: MBA (Finance & International Business), University of California, Berkeley (71), MBA, Lund University (69).
Work Experience: Gränges AB, various positions in finance (72–80), AB Electrolux, CFO (80–00).
Board Member: Investment AB Öresund, Spendrup Invest AB, Profoto AB, Advisory board member of CALYON, Stockholm branch, Chairman of Ekman & Co AB (trading house).

Dr Klaus Rauscher Born 1949
Senior Executive Vice President Vattenfall AB and Head (Vorstandsvorsitzender) of Vattenfall Europe AG since 2002
Education: Dr. Jur., Erlangen-Nuremberg University.
Work Experience: Bayerische Staatskanzlei, Munich, Ministerial Director, Bayerische Staatsministerium der Finanzen, Munich, various managerial positions, (75–88), Bayerische Landesbank, Munich, bank director, (91), Bayerische Landesbank Girozentrale, Munich, member of executive management (Vorstand) (92–02).

Hans von Uthmann Born 1958
Senior Executive Vice President and Head of Vattenfall Nordic since 2003.
Education: Stockholm School of Economics.
Work Experience: Shell Group, various managerial positions (84–94), Shell International, London, head of business and strategy consultants (94–96), AB Svenska Shell, MD (96–00), Duni AB, head of strategic development, Duni AB, MD and President (00–03).

Lennart Billfalk Born 1946
Executive Vice President, Group Function Strategies since 2000
Education: MSc (Civ. Eng), Chalmers University of Technology, Gothenburg, PhD (Hydraulic Engineering), Royal Institute of Technology, Stockholm.
Work Experience: Scandinavian Engineering Corporation, Algeria, Consulting Engineer (71–73), River and Harbour Laboratory, Trondheim, Norway, Research Engineer (73–76), Vattenfall, Research Engineer (76–79), Head of Hydro Power Div., Älvkarleby Laboratory (79–82), Director, Älvkarleby Laboratory (82–90), Vattenfall, MD, Vattenfall Development (90–92), Elforsk, MD (93–97), Head of Group Strategy Vattenfall AB (98–00).

Ann-Charlotte Dahlström Born 1952
Senior Vice President, Group Function Human Resources since 2001
Education: MA, Stockholm University (76), various management courses,
Work Experience: Recruitment office manager, recruitment officer, personnel manager (76–85), Stockholm County Council. Ericsson (various companies), personnel manager (86–99), SEB, personnel manager (00–01).
Board Member: Etikakademin, EFA, International University Bremen, Advisory Board.

Mats Fagerlund Born 1950
Executive Vice President, Group Function Legal Affairs and M&A since 1992. Head of Distribution and Transmission within Vattenfall Europe since 2003.
Education: Bachelor of Law, Stockholm University.
Work Experience: Ahlsell AB, company lawyer (85–87), Ericsson, head of legal affairs (87–92), Vattenfall AB (92–), head of legal affairs and director.

Tuomo Hatakka Born 1956
Senior Executive Vice President Vattenfall AB since 2005 and Head of Vattenfall Poland since 2001
Education: Helsinki Schools of Economics and Business Administration, Instituto de estudios superiores de la empresa, Barcelona, Spain.
Work Experience: Bain & Company, London, UK, Manager (85–91), Company Assistant Limited, Warsaw, Poland, Director, Partner (92–93), Enterprise Investors, Warsaw Poland, Executive Vice President, & Partner (94–99), Elektrim Kable SA, Warsaw, Poland, President & CEO (00–01).

Knut Leman Born 1950
Senior Vice President, Group Function Communications since 2000.
Education: Diploma in Market Economy, DIHM, PR and Journalism, Skurups Folkhögskola.
Work Experience: AB Volvo, Information Officer (91–97), Bure Equity AB, Information Officer/Account Manager (97–00).
Board Member: Swedish Marketing Federation.

Carl Alf Lindfors Born 1946
Executive Vice President and Head of Nordic Generation since 1999
Education: Civil engineering, mechanical engineering, Royal Institute of Technology, Stockholm, nuclear engineering, Vattenfall, reactor technology, higher education, Royal Institute of Technology, Stockholm.
Work Experience: Assistant positions, Västerås Power Plant, Ågesta CHP (71–75), Forsmarksverket Power Plant, various managerial positions (75–92). MD of Forsmarks Kraftgrupp AB (92–97), Vattenfall AB, personnel manager (97–99), Head of Vattenfall Electricity Generation (99–), chairman of Elnät Sverige (00–02).
Board Member: Forsmarks Kraftgrupp AB, board chair, Ringhals AB, Barsebäck Kraft AB, Svensk Kärnbränslehantering AB, chair of Swedish Nuclear Power Safety Council.

1) Board positions within wholly-owned subsidiaries of Vattenfall are not listed here.

RISKS AND RISK MANAGEMENT

Vattenfall's operations are exposed to a number of risks. Vattenfall has established a risk management organisation and process which is comprised of the following components:

- Standardised risk definitions.
- Identifying origination of risks.
- Reliable methods for measuring risks.
- Effective risk management for manageable risks.
- Reporting in accordance with established routines.
- Management in accordance with established strategies and fixed rules.

Risk mandate and risk management structure

The Board has overall responsibility for internal control and risk management within Vattenfall. Vattenfall's Board has, in turn, given Vattenfall's management a risk mandate. Management allocates this mandate to Vattenfall's business units in accordance with a delegation structure. Each unit manages its own risks and has some room to manoeuvre within its respective mandate. The results within units are continually followed up and reported to executive management by an independent risk control function, Group Risk Control, which is also responsible for supervision of the Group's overall risk mandate. It is also the responsibility of Group Risk Control to map out risks in the organisation and to develop appropriate models and measurement methods for managing these risks.

The Risk Committee

The Group's risk management and reporting is coordinated by a Risk Committee under the CFO's leadership. The Committee's task is to scrutinise policies and mandates and to approve risk instructions and the risk models applied within the Group.

Political risks, operational risks, environmental risks and legal risks are of a general nature and are present within all Group units. The more specific risks in each respective part of the value chain are presented on pages 62–63.

Electricity price risk

The price of electricity is determined by availability and demand. An important factor for demand is temperature; in the Nordic countries, for example, cold weather leads to higher demand due to increased

heating needs while in Continental Europe unusually warm summer temperatures leads to higher demand due to air conditioning needs. Other important factors for demand are the industrial economic situation and fuel prices.

Availability is determined by available capacity and varies. In the Nordic countries, for example, available capacity varies mainly with precipitation and the associated water supply (hydro power) while in Continental Europe it varies with the irregular feed-in of wind power.

Each hour the price is set to the market equilibrium, that is, the point where supply meets demand (see pages 22–23). For most of the year, and in most of Vattenfall's markets, electricity generation, and thereby the production cost, is dependent on some type of fossil fuel. As a result, the cost is also a reflection of the price of emission allowances for carbon dioxide and the market price of, for example, oil, natural gas or coal. Vattenfall's electricity price risk is therefore also a risk based on weather (temperature and precipitation), the price of oil, natural gas, coal and emission allowances for carbon dioxide.

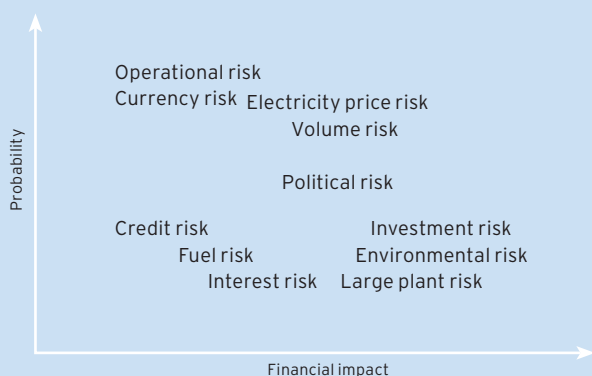
The electricity price risk is the risk that has the greatest impact on Vattenfall's financial performance.

In order to manage uncertainty in electricity price trends, Vattenfall hedges its generation and sales through the physical and financial electricity contracts available in the market. Such hedging is made while taking into account the liquidity in the market for different periods of time. The Group hedges in accordance with established mandates and generally three years ahead.

The business units conduct their hedging in Vattenfall's different markets through Vattenfall Trading Services, which hedges itself in the external market through, for example, the Nordic electricity

Risks in Vattenfall's operations

Probability of financial impact on Vattenfall's profit



A risk that has a large probability of affecting Vattenfall's financial performance is the electricity price risk. The company's net position is hedged to a certain extent through financial instruments. For the part that is not hedged, in the case of Germany and the Nordic countries a price movement of 5 per cent would affect profit for the coming three years by approximately SEK 3,500 million. If the hedged part should increase, the reliability of the outcome (financial performance) also increases. During the year prices varied by about 35 per cent.

The fuel price risk mainly affects Vattenfall indirectly through the effect on electricity prices. The direct effect of an increase in coal prices, which affects production costs, is marginal due to the high degree of hedging.

As for currency risk, this is mainly attributable to translation exposure in equity in currencies other than SEK (see the description in the section on currency risk), see Note 35 of the consolidated accounts, pages 95–97. There is also interest risk described.

Plant risk is described in the illustration on risk management along the value chain page 62–63.

exchange Nord Pool and the German electricity exchange, EEX (European Energy Exchange).

The mandates allocated to the different business units regulate which electricity price risk that is acceptable. Exposure is followed up in relation to the mandate on a daily basis. In order to measure electricity price risks, Vattenfall applies methods such as Value at Risk (VaR) and Profit at Risk (PaR) together with various stress tests.

Investment risk

Before any investment decision is made, the risks are analysed. By simulating different outcomes of, for example, prices, costs, delays and cost of capital, the risks involved in each individual investment are assessed.

Nordic Generation, for instance, has a broad investment portfolio with the repair and maintenance of nuclear power, hydro power and dam installations, which have placed increasing demands on systematic risk management.

The largest investment programme concerns upgraded safety levels and increased lifetime and power output from nuclear power and encompasses a total of about SEK 24 billion until the year 2012. This means that the availability of, for example, suppliers and engineers and access to government authority resources to obtain permits are critical factors that must be considered if the large plethora of projects that Vattenfall, and even other power plant owners, plan are to function. The successful implementation of the programme within the established time schedule is decisive for profitability. Throughout the year risk analysis was conducted to illuminate and quantify internal and external risks associated with all nuclear power plant investments. In order to minimise these risks action plans have been drawn up to systematically minimise, manage and monitor the different risks throughout the implementation of investment projects.

Plant insurance protection

Vattenfall's largest insurable risks are associated with the operation of power generation and heat production plants.

The nuclear power plants in Sweden have insurance cover for property damage through EMANI, a European mutual insurance company. The Nordic Nuclear Insurance Pool participates in this insurance programme in Sweden, and also issues nuclear liability insurance. The German nuclear liability risk is insured by the German Mutual Atomic Energy Reinsurance Pool, and by the mutual undertaking between German power plant operators.

Vattenfall Insurance, a captive company, provides the non-nuclear facilities of the Swedish and German units and companies with insurance cover against property damage and consequential losses. The Group companies in Finland and Poland are insured through their respective local insurance markets.

Electricity transmission and distribution networks are uninsured, with the exception of transformer stations and switchgear. The reasoning is that these risks are not generally covered by most insurance providers. Vattenfall continually works to reduce electricity network vulnerability.

In Sweden, liability for damage to third parties as a result of dam accidents is strict and unlimited. Vattenfall and other hydro power producers have therefore taken out dam liability insurance together.

Vattenfall Reinsurance S.A. in Luxembourg reinsures part of Vattenfall Insurance's insurance commitments. Economies of scale and direct access to the international reinsurance market mean that overall insurance costs can be kept low.

Political risk

Political risk is defined as the business risk that may arise as a result of political decisions. Examples of this are price regulation within electricity distribution and transmission, uncertainty with regards to a new political majority or changes in fiscal policy. In conjunction with acquisitions and other investments, this type of risk is managed by adjusting the cost of capital.

Another type of political risk consists of changes in the regulations that affect the energy sector. This may concern changed taxes, environmental charges and changes in the way natural monopolies are regulated. This type of risk is difficult to predict and protect oneself against. As a result, Vattenfall is actively engaged in monitoring socio-political and economic factors and keeping in contact with decision-makers in all relevant markets. Vattenfall is also a member of national and international trade organisations.

Operational risk

Operational risk is defined as the risk of incurring financial losses, or loss of confidence, due to mistakes or shortcomings in the company's administrative routines.

Operational risks can be divided into the following categories:

- Administrative risks – risks of losses due to shortcomings in the company's division of responsibility, competence, reporting routines, risk measurement and evaluation models, and in control and follow-up routines.
- Legal risks – a risk of losses arising from the non-fulfilment of contracts due to shortcomings in documentation, counterparts lacking the right to conclude contracts or uncertainties regarding contract validity.
- IT risks – risks that entail a risk of losses due to shortcomings in IT systems.

Each business unit is responsible for limiting and managing operational risks within Vattenfall by ensuring that well-documented routines, reliable IT systems and satisfactory internal controls are in place. For more information about internal control, see the report on internal control on page 57.

Environmental risk

Environmental risks can be divided into two categories – environmental liabilities and environmental risks. Environmental liabilities refers to environmental problems that have been identified in production plants, installations or operations and for which requirements on measures can be expected through more stringent legislation, restricted permits or stipulations in the company's environmental policy. Environmental risks refers to the possibility of accidents and shortcomings in operations, and their impact on the environment.

Work to prevent and control risks is carried out largely on a local basis, and is based on the knowledge and experience present within the Group's units. The environmental risks and environmental liabilities in the Group's business units are comprehensively mapped and analysed on a continual basis. The business units are responsible for identifying and expressing risks in monetary terms, together with a probability factor. With this risk inventory, we increase the possibilities to implement measures that reduce the Group's impact on the environment.

Consequences of environmental risk can entail such things as:

- Decontamination/clean-up costs
- Damages to persons and property
- Loss of production
- Effects of the questioning of the Vattenfall brand
- Opinions and policies that lead to more difficult permit processes and production limitations

Business units report with regards to environmental liabilities within the following areas:

- Air, water and ground pollution
- Noise
- Landfills
- Oil-filled cables with lead encapsulation
- Mercury in electrical equipment and fumes

- Insulation in electrical equipment
- Asbestos in thermal power plants and CHP plants
- Magnetic fields from transformers and power lines
- Modernisation of measurement equipment

Environmental liabilities are mapped and analysed for decisions on measures to be taken. At present, an action programme is underway for Vattenfall's hydro power plants in Sweden and Vattenfall's acquired operations in Poland. Vattenfall sees keeping ahead in this

area as a way of strengthening the Group's competitive edge in the long-term. In the German companies, funds have been reserved for restoring polluted land and action plans have been drawn up in consultation with the authorities involved.

One of the considerable challenges for Vattenfall and the energy sector is to reduce emissions of climate-affecting carbon dioxide from fossil-fired power plants. Societal representatives place much focus on this issue, and Vattenfall is approaching it with an integrated risk perspective, which includes both technological and political

Risk management along the value chain

The illustration shows examples of risks along Vattenfall's value chain and how Vattenfall manages these risks.

Environmental risks and environmental liabilities

Environmental risks refers to the possibility of accidents and short-comings in operations and their impact on the environment. Environmental liabilities refers to identified environmental problems for which requirements for measures can be expected. These are handled through mapping, analysis and decisions on measures.

Plant risk

Vattenfall's production plants can be damaged due to near-accidents and breakdowns, which in general also entail consequential losses. Loss-prevention measures and comprehensive maintenance, training and good administrative routines minimise such risks. As far as possible, insurance policies protect the Group against major financial losses.

Price area risk

Price area risks arise when electricity prices differ between geographic areas due to shortages in transmission capacity between areas. This risk is controlled centrally and is managed by Vattenfall Trading Services. In the Nordic countries, where Nord Pool provides a market for the financial instruments used to regulate this risk through area swaps, the price area risk is managed through trading in such area swaps. Through Vattenfall's obligation to be a market maker on Nord Pool, the liquidity of these instruments is secured and in this manner Vattenfall contributes to spreading risks for other players. In the physical trading of foreign cables outside the Nordic countries, the price area risk is managed through hedges in each particular area.

Electricity price risk

Risk of loss on account of changes in the wholesale price of the electricity in which Vattenfall conducts physical and financial trade. The price of electricity is greatly affected by fundamental factors such as water supply, fuel prices, emission allowances for carbon dioxide, temperature changes and electricity consumption, so the continual analysis of these aspects is an important factor for success. Vattenfall manages this risk by selling and buying electricity futures and forwards. Deals on the different electricity markets are made through Vattenfall Trading Services' market access function. The Board of Vattenfall has issued mandates specifying how large an electricity price risk is acceptable. These mandates are followed up against exposures on a daily basis. In order to measure electricity price risks, Vattenfall applies Value at Risk (VaR), Profit at Risk (PaR) and various stress tests.

Electricity/heat generation

Electricity price risk

Earnings risk on account of changes in the wholesale price of the electricity generated in Vattenfall's production plants. In order to evaluate electricity price risk, Vattenfall simulates expected electricity spot market outcomes. Forecasts for expected generation are established and these parameters provide the basis for deciding how large a proportion to hedge. Factors that affect the electricity price risk include changes in electricity consumption, the price of coal and emission allowances for carbon dioxide, water supply and temperature changes. Vattenfall manages the electricity price risk by hedging its expected production through forward trading in electricity. In this way, profit distribution is evened out over time.

Fuel price risk

Risk of loss on account of changes in the market price of the fuels that Vattenfall uses in its production plants. The measurement and management of fuel price risk is conducted within the individual production units. Fuel prices are affected by such things as macroeconomic factors. Vattenfall manages fuel price risks by forecasting and analysing price developments and planning fuel purchases. Financial and physical instruments, such as coal and oil, are used to even out the outcome over time.

Trading

Credit risk

Risk of loss resulting from the counterpart in a transaction not fulfilling its obligations. In order to manage and limit this risk, Vattenfall uses external rating information (when available, otherwise internal models) to establish the creditworthiness of its counterparts. Individual limits are established for each counterpart and each counterpart is regularly assessed. Exposure is followed up in relation to the credit limits on a daily basis. If necessary, additional credit assurances are demanded in the form of, for example, a guarantee from the parent company or a bank. In those cases where general agreements are entered, net calculations of debts and receivables for an individual counterpart are permitted. In those cases where Vattenfall has more than one general agreement with the same counterpart, a so-called master netting agreement is desirable in order to calculate the net debt and receivables amount, even when trading in different raw materials, such as electricity, coal and gas. When contracts are closed in marketplaces such as Nord Pool and EEX, which offer central counterpart clearing, the risk is in the market instead.

Currency risk

Currency risk is the risk of negative effects on Vattenfall's earnings and balance sheet as a result of exchange rate fluctuations. In Nordic operations, most transaction exposure is in NOK and EUR in conjunction with the hedging of electricity prices, primarily in Nord Pool. This currency exposure is hedged with forward exchange rate contracts.

aspects. Vattenfall has, among other things, initiated a project for large-scale separation and storage of carbon dioxide.

The project is partly financed by the EU and is being carried out in cooperation with a number of larger utilities, including RWE.

Financial risks

The Group's financial risks are mainly managed by Vattenfall Treasury AB, which houses the Group's internal bank and finance function. These finance operations are intended to provide cost-effective

management of the Group's financial risks.

The Group's funding, investments and currency trading are mainly carried out by Vattenfall Treasury AB and, to a lesser extent, by Vattenfall Europe AG. The Group's liquidity is centralised using so-called group cash pool systems. Speculative investments are made to a limited extent within fixed risk limits. For a more detailed description and quantification of financial risks, see Note 35 of the consolidated accounts.



ADMINISTRATION REPORT

The Board of Directors and President of Vattenfall AB (publ), Swedish corporate identity number 556036-2138, hereby submit the annual accounts and consolidated accounts for 2005, encompassing pages 64–112.

Group operations and structure

Vattenfall generates, distributes and sells electricity and heat, conducts electricity trading and offers energy-related services and, to a certain extent, telecom services. Vattenfall's vision is to be a leading European energy company. The majority of operations are located in Sweden, Finland, Germany and Poland, and the primary segments comprise the Nordic Countries, Germany and Poland. The number of customers amounts to some 5.8 million, including those through jointly-owned companies. The Group has more than 32,000 employees. Vattenfall AB is wholly owned by the Swedish state. The Board of Directors has its headquarters in Stockholm.

The year in brief

- Net sales increased by 13.9 per cent to SEK 129,158 million (113,366).
- Operating profit increased by 62.1 per cent to SEK 27,730 million (17,112); excluding items affecting comparability¹ by 28 per cent to SEK 24,744 million (19,327).
- Profit for the year increased by 113.6 per cent to SEK 20,518 million (9,604); excluding items affecting comparability by 59.2 per cent to SEK 17,364 million (10,909).
- Return on equity increased to 26.4 per cent (13.7); excluding items affecting comparability to 22.0 per cent (15.6).
- Return on net assets increased to 18.0 per cent (11.6); excluding items affecting comparability to 15.9 per cent (13.3 per cent).
- Cash flow before financing amounted to SEK 728 million (13,472).
- Investments totalled SEK 24,497 million (12,731), of which growth investments SEK 14,415 million (4,312) and maintenance investments SEK 10,082 million (8,419).
- Net debt increased by SEK 8,932 million to SEK 64,343 million from SEK 55,411 million as of 31 December 2004.
- The Board of Directors proposes a dividend of SEK 5,800 million, corresponding to SEK 44.04 per share.

Electricity and heat generation 2005 compared with 2004

Vattenfall's total electricity generation increased by 1.2 per cent to 169.1 TWh (167.1). Hydro power generation increased by more than 18 per cent to 39.9 TWh (33.6), the result of good water supply. Nuclear power generation decreased by 5.6 per cent to 58.9 TWh (62.4), mainly due to the closing of Barsebäck 2. Fossil-based power decreased marginally to 69.8 TWh (70.5). Heat generation decreased by 1.2 per cent to 34.1 TWh (34.5), chiefly due to warmer weather.

Important events

Long-term agreements with basic industries
During the year, Vattenfall signed several major long-term supply agreements – up to 10 years – with Swedish basic industries.

First quarter

Storm caused major network disruptions
At the beginning of January 2005, southern Sweden was hit by a widespread storm with hurricane-force winds. The damage to forests, infrastructure and the electricity network was enormous. Vattenfall's costs for electricity network repairs, disruption guarantees, damages and additional work amounted to more than SEK 500 million.

Vattenfall gathers the Group's energy trading under one name
Vattenfall's energy trading was gathered under one name, Vattenfall

1) Items affecting comparability: For 2005, items affecting comparability consist chiefly of compensation/impairment losses for the closing of the Barsebäck 2 nuclear power plant of SEK 3,057 million net and, for 2004, restructuring costs in Germany of SEK –3,034 million, as well as capital gains/losses of SEK 819 million net.

Trading Services, after Vattenfall's trading units in Hamburg and Stockholm were merged. The new unit has its headquarters in Hamburg. Activities in the Nordic market are managed from the regional office in Stockholm. A new regional office was established in Gliwice in southern Poland.

Second quarter

Acquisition in Denmark
In April, Vattenfall acquired 35.3 per cent of the shares in the Danish company Elsam A/S for approximately SEK 10.3 billion. In June, an agreement in principle was signed with the Danish oil and gas company Dong A/S according to which Vattenfall will take over approximately 24 per cent of the total generation capacity of Elsam and Energi E2 A/S, the Danish companies acquired by Dong, in exchange for the shareholding in Elsam. The EU's anti-trust authority gave its approval to Vattenfall's part in the transaction on 23 December.

Open annual general meeting and amended articles of association
On 26 April, Vattenfall held its first ever open annual general meeting. Previously, the meeting had only been open to members of the Swedish parliament. More than 250 people attended the meeting. After the formal procedures, the public was offered the opportunity to pose questions directly to Vattenfall's Chairman of the Board and Chief Executive Officer. The meeting decided on an addition to the articles of association stating that "the Company shall, within the framework of businesslike operations, be the leading company in the transition to an ecologically and economically sustainable Swedish energy supply".

Pilot installation for carbon dioxide-free coal-fired power plant
In May, Vattenfall announced that it is to build the world's first pilot installation for a carbon dioxide-free coal-fired power plant based on so-called oxyfuel technology. The installation will be built adjacent to Vattenfall's coal-fired power plant Schwarze Pumpe in eastern Germany with an investment of approximately SEK 370 million. The installation is expected to be put into operation in 2008.

Investment in wind power
Vattenfall has acquired the rights to develop the Swedish part of Kriegers Flak, an area in the southern part of the Baltic Sea, where there is the opportunity to build a wind power farm of 100–150 wind turbines totalling 600 MW, corresponding to 1.6 TWh per annum. The project is currently under appraisal.

Innovative issue of Capital Securities
In June, Vattenfall issued hybrid bonds in the form of Capital Securities of EUR 1,000 million. These Capital Securities are reported as interest-bearing non-current liabilities. See Note 33 of the consolidated accounts.

Improved credit rating
In June, both Moody's and Standard & Poor's changed their "outlook" from stable to positive. Moody's also raised its credit rating for long-term borrowings from A3 to A2 and for short-term borrowing from P-2 to P-1 as a result of its new GRI (Government Related Issuer) methodology. The credit rating from Standard & Poor's is A- for long-term borrowing and A-2 for short-term borrowing.

New Code of Conduct
Vattenfall's core values, company philosophy and ethical attitude has been summarised in a Code of Conduct and approved by Vattenfall's Board. It describes how the employees of the Vattenfall Group should work and is an important tool in attaining our strategic goals.

Third quarter

New energy law in Germany
On 13 July, the new German energy industry act (EnWG) came into force. As a result, the new German network regulator, Bundesnetzagentur, was able to begin its work. Initially, all tariff changes must be approved in advance by the regulator. The aim is to make the transition to an incentive-based regulatory model in 2007.

Poland reorganised as Business Group

In August, operations in Poland were reorganised into Business Group Poland and sub-divided into three business units, Distribution, Sales and Heat. This puts Poland on the same level in the Group's organisation as Business Group Vattenfall Nordic and Business Group Vattenfall Europe in Germany.

Fourth quarter

Agreement concerning compensation for Barsebäck 2

In November, following negotiations between the Swedish state, E.ON Sverige AB and Vattenfall AB, an agreement was reached regarding compensation on market terms for the loss of generation at Barsebäck 2. The second reactor at the Swedish Barsebäck nuclear power plant was closed down on 31 May in accordance with the Swedish government's decision and Swedish legislation. Vattenfall will receive compensation for future production losses amounting to SEK 4,100 million. Vattenfall's impairment losses of the concerned assets amount to SEK 1,043 million, which means the consolidated income statement for 2005 has been credited with the resultant net, SEK 3,057 million. The state compensation will be paid to Vattenfall in equal instalments up until 2009.

Decisions regarding wind power farm and waste incinerator

In November, Vattenfall decided to build a wind power farm at Lillgrund in Öresund. Lillgrund represents the largest investment in wind power in Sweden and one of the largest in Europe. The farm will have a capacity of 110 MW, corresponding to more than 0.3 TWh per annum. The installation is expected to be put into operation in 2007. A decision was also made to build the Rüdersdorf waste incinerator outside Berlin with a capacity of 30 MW and an estimated electricity output of approximately 0.2 TWh.

Squeeze-out of minority shares in Germany

In August, Vattenfall announced that its shareholding in the listed German subsidiary Vattenfall Europe AG exceeds 95 per cent. In

December, the decision was made to hold an extra general meeting in March 2006 at Vattenfall Europe AG for a decision on the squeeze-out of the minority owners' shares. This is the concluding stage of our successful establishment in the German market, which began in November 1999 with the acquisition of 25.1 per cent of HEW AG. We are emphasising the fact that Vattenfall's involvement in Germany is long-term and creating stable conditions for continued growth in the European energy market.

Increased energy taxes in Sweden

The Swedish parliament decided to increase property tax on hydro power and the tax on installed nuclear power capacity, effective 1 January 2006. For Vattenfall, this entails increased annual costs of approximately SEK 1.5 billion.

Vattenfall receives several awards

- First prize in the Stockholm Stock Exchange's prestigious Annual Report competition "Best Annual Report 2004"
- International Epica Award, Media Trendy and EFFIE Award for creativity, media innovation and performance, respectively, in our well-received introductory campaign in Poland.
- TIME Magazine named Vattenfall's CEO Lars Josefsson one of the TIME European Heroes 2005 for his strong commitment to the issue of climate change.

New Group function for capacity management

Vattenfall faces a period of major capital expenditures. A new joint group function, Capacity Management, has been formed to coordinate these investments in heat and electricity generation.

A common brand is being built

On 1 January 2006, Vattenfall's German subsidiaries Bewag and HEW, as well as the Polish subsidiaries EW and GZE, were renamed Vattenfall. The units within Polish GZE now also operate in the market under the Vattenfall name.

Breakdown of investments 2005 and 2004

SEK millions	Nordic Countries		Germany		Poland		Other		Eliminations		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Electricity Generation												
Hydro power	819	735	97	148	-	-	-	-	-	-	915	883
Nuclear power	2,140	1,408	167	155	-	-	-	-	-	-	2,307	1,563
Fossil-based power (incl mining operations)	-	-	1,803	1,633	-	-	-	-	-	-	1,803	1,633
Renewable energy	18	-	254	24	-	-	-	-	-	-	272	24
Other	223	164	186	379	-	-	-	-	-	-	409	543
Total Electricity Generation	3,200	2,308	2,507	2,340	0	0	0	0	0	0	5,707	4,647
Heat (incl. CHP)												
Heat	657	700	546	821	487	213	-	-	-	-	1,690	1,734
Renewable	-	-	203	6	-	-	-	-	-	-	203	6
Other	17	14	116	75	-	-	-	-	-	-	134	89
Total Heat	674	714	866	902	487	213	0	0	0	0	2,027	1,829
Electricity Networks												
Electricity Networks	2,502	1,804	1,297	1,035	267	236	-	-	-	-	4,067	3,075
Other	240	109	79	75	-	-	-	-	-	-5	318	179
Total Electricity Networks	2,742	1,913	1,376	1,110	267	236	0	0	0	-5	4,385	3,253
Acquisitions (shares)	10,484	158	56	697	3	1,576	1,184	2	-19	-	11,709	2,433
Other (excl Acquisitions)	331	218	268	277	55	58	16	15	-	-	670	568
Total	17,432	5,310	5,072	5,327	812	2,082	1,200	17	-19	-5	24,497	12,731
% of total investments	71.2	41.7	20.7	41.8	3.3	16.4	4.9	0.1	-0.1	0	100	100

Comments: Investments increased by 92.4 per cent compared with 2004, mainly due to the acquisition of 35.3 per cent of the shares in the Danish power company Elsam A/S for SEK 10,325 million. Of total investments, shares represented 48.8 per cent in 2005 as against 19.1 per cent in 2004. Within Electricity generation the largest investments were made within nuclear power in Sweden. Heat investments were split roughly equally

between the Nordic Countries and Germany, somewhat lower in Poland. Network investments were chiefly made in Sweden and were attributable to electricity network expansion and the installation of remote-readable electricity meters. For further information about Vattenfall's investments in renewable energy in the Nordic countries, see page 26.

Important structural changes

The single largest structural deal was the acquisition of 35.3 per cent of the shares in the Danish company Elsam A/S for SEK 10,325 million. In addition to this, shares were acquired in the German subsidiary Vattenfall Europe AG and Vattenfall AB's direct and indirect holdings increased to almost 97 per cent. Further details of important structural deals in 2005 are set out in the table in Note 5 of the consolidated accounts on page 85.

Personnel

(Number of employees, full-time equivalents)			
Amounts in SEK millions	2005	2004	Change, %
Finland	546	543	+0.5
Poland	3,031	3,309	-8.4
Sweden	8,350	8,192	+1.9
Germany	20,199	20,864	-3.2
Other countries	105	109	-3.7
Total	32,231	33,017	-2.4

The reductions in Poland and Germany are the result of rationalisation initiatives. The increase in Sweden is explained by the extensive investment programmes for the maintenance of Vattenfall's generation plants and newly acquired operations in the Services Nordic Countries business unit.

Research and development (R&D)

As a natural part of business development, Vattenfall pursues technical research and development, R&D, with a strong emphasis on development, that is, the application of existing knowledge. The purpose is to provide our customers with better service and desirable products as well as to increase the efficiency of our processes and systems. A large part of this work concerns reducing the environmental impact of our activities and contributing to sustainable development in society.

For the Group as a whole, investment in R&D during 2005 amounted to SEK 650 million (529). About half of this amount, or SEK 325 million, was attributable to Vattenfall's subsidiary Svensk Kärnbränslehantering AB (SKB). SEK 56 million was invested in R&D in renewable energy, while SEK 62 million was invested in R&D in alternative methods for reducing the Group's carbon dioxide emissions. As a percentage of the Group's sales, R&D costs correspond to 0.5% (0.5), which is on a par with Vattenfall's most important peers.

Management of R&D

Each business unit is responsible for the future development of its own operations, including technical research and development, R&D. The emphasis is primarily on continual improvements for increased efficiency, availability and safety and reduced environmental impact in existing plants and processes.

As an example of tangible development, we can mention investments in measures to increase availability in Vattenfall's electricity networks. A number of different projects aim to reduce carbon dioxide emissions from both heat and electricity generation through improved plant efficiency and increased biofuel use. Measures to improve efficiency are also being implemented in carbon dioxide-free generation, as well as in hydro and nuclear power. The development of methods and technologies for storing spent nuclear fuel constitutes considerable efforts, which are carried out by Svensk Kärnbränslehantering AB.

For certain issues of a strategic nature, development is organised in joint Group programmes, for which the Group Strategies team is responsible. For example, a major investment is being made in the development of a technique for separating carbon dioxide from the combustion of coal, with later storage in the bedrock. Another programme is focused on improved availability and reduced costs in electricity networks through the use of information technology. The joint Group programmes are run in close collaboration with the business units in all of Vattenfall's core markets for a number of reasons, such as to optimise the introduction of programme results in business operations.

Environmental impact within the Group

The Group runs operations in Sweden, Finland, Germany and Poland for which permits are required by the national legislation of each country. Such operations include the generation of electricity and heat and, in Germany, the extraction of lignite in four open-cast mines.

The Group conducts considerable network operations for the distribution and transmission of electricity in accordance with concessions held in Sweden, Finland, Germany and Poland. The Group also has its own railway operations in Germany.

In Sweden, the generation of electricity is conducted in several hydro power plants, both large and small, seven nuclear power plant units, wind power plants and, to a certain extent, combustion plants. In Finland, electricity is generated in one large hydro power plant and several small hydro power and wind power plants, as well as in a thermal power plant. In Germany, electricity is generated in several large combustion plants, three nuclear power plants, several medium-sized combined heating and power (CHP) plants in Hamburg and Berlin and in several smaller wind power and hydro power plants. Some of the hydro power plants are so-called pumped storage plants, two of which are of considerable size. In Poland, electricity is generated in two CHP plants in Warsaw. In addition, the Group owns shares in the German Stade nuclear power plant, which was taken out of operation in 2003, and has partial responsibility for Barsebäck, the now closed Swedish nuclear plant.

In Germany, heat is produced in several large and medium-sized combustion plants, primarily in Hamburg and Berlin, but also in other locations. In Poland, heat is produced in four combustion plants in Warsaw. In Sweden, heat is produced in combustion plants in several locations. In Finland and the Baltic states, heat is produced in several locations, distributed between one large plant and several smaller installations.

In Germany, there are plans to build within a few years a new lignite-fired power plant unit for electricity generation and two new natural gas and coal-fired CHP plants in Berlin and Hamburg. In 2005, the decision was made to build a pilot installation for a carbon dioxide-free coal-fired power plant based on so-called oxyfuel technology. The installation will be built adjacent to Vattenfall's coal-fired power plant Schwarze Pumpe in eastern Germany. The installation is expected to become operational in 2008. The plan is to store separated carbon dioxide 1,000 metres underground. Like power plants and CHP plants, an installation for the separation of carbon dioxide and carbon dioxide storage requires a permit under German legislation. A planned new lignite-fired power plant unit will entail renewed extraction of lignite from currently dormant open-cast mines. The necessary permits for renewed extraction have already been obtained.

The construction of an offshore wind power farm comprising 48 wind turbines at Lillgrund in Öresund will begin in 2006. Procurement began in 2005. The farm is estimated to become operational in 2007. Plans are also under appraisal for another offshore wind power farm comprised of 128 wind turbines in the Swedish part of Kriegers Flak in the southern part of the Baltic Sea.

In 2005, Vattenfall came to an agreement with the Danish power company Dong A/S as to how joint assets are to be split. According to the agreement, Vattenfall will become a major player in combined heat and power and wind power in Denmark. The transaction is expected to be completed during 2006, once the EU's anti-trust authority has made a decision on Dong's various acquisitions in Denmark. Vattenfall has received approval for its part in the transaction.

Poland's entry into the EU in 2004 entailed the country having to adapt its national environmental legislation to that of the EU. This means that Vattenfall's installations in Warsaw that require permits will be subject to reassessment during the next few years, in accordance with transitional regulations currently in force for existing installations. Preparations are underway with the purpose of ensuring that the new regulations are fulfilled in time.

The EU system for trading in emission allowances for carbon dioxide was introduced in 2005. All of the Group's important combustion plants are encompassed by the trading system. As a result, the trading system has had a substantial impact on the Group's operations in Germany and Poland, as well as on heat operations in Sweden and Finland. Vattenfall has received emission allowances which for the most part cover the Group's needs. For heat operations in Sweden, in

accordance with the Swedish allocation plan, only 80 per cent of the Group's requirements have been received, which means the remaining emission allowances must be purchased in the market.

Environmental impact in the parent company and Swedish operations

The parent company conducts operations that require permits in accordance with the Swedish Environmental Code. These operations mainly comprise combustion plants for the generation of electricity and heat and wind power plants.

The parent company has 36 combustion plants for heat and electricity generation that require permits, as well as 30 heat and cooling plants that require registration. The combustion plants for the generation of electricity that require permits are the two power plants in Stenungsund and Marviken, two gas turbine plants and one diesel power plant used for reserve power. The parent company has a total of 39 wind power turbines, which are located both separately and in groups. The wind power turbines have been erected in such a way that 15 turbines require permits and the remainder require registration. The parent company also has hydro power plants with associated water regulation facilities that are subject to review under the Swedish Environmental Code. The parent company conducts fish farming requiring a permit at one installation.

One CHP plant and some smaller thermal plants are subject to review or registration. The company's profits and financial position are not dependent on the outcome of these reviews.

The Group's Swedish subsidiaries also conduct operations that require permits under the Swedish Environmental Code. Forsmarks Kraftgrupp AB and Ringhals AB generate electricity in nuclear power plants. SKB operates an installation for the final storage of low and medium level radioactive waste in Forsmark and an installation for the intermediate storage of spent fuel in Oskarshamn. In several subsidiaries, electricity and heat are generated mainly in combustion plants. The Group runs network operations in Swedish subsidiaries for the distribution of electricity, in accordance with concessions.

The Ringhals nuclear power plant is subject to examination for authorisation for environmentally hazardous activities, in accordance with transitional regulations associated with the introduction of the Swedish Environmental Code. In accordance with a decision by the Swedish government, Barsebäck 2 was closed on 31 May 2005. The work to wind down operations at the Barsebäck plant began in 2005 and will successively continue as soon as the radiological conditions allow and the necessary permits have been obtained. E.ON Sverige AB (formerly Sydkraft AB) is responsible for the winding down and dismantling in accordance with a power agreement from 1998 between Vattenfall, E.ON Sverige and the Swedish State.

In the autumn of 2004, all the necessary rights were acquired for the building of 48 wind turbines in Örestad wind power farm in Öresund, off the coast of Skåne in the south of Sweden. When operations are commissioned in the autumn of 2007, Vattenfall will have more than doubled the number of wind power turbines and increased electricity generation from wind power by a factor of six from 54 to 370 GWh. The permit required under the Swedish Environmental Code was obtained in 2005. The issuing of this permit has been appealed by a third-party. Appeal proceedings will take place during 2006.

Projects are underway at nuclear power plants and hydro power plants with the aim of increasing the power output of existing plants. These power improvements are conducted in part within the confines of existing permits. In certain cases, new permits may be required.

The generation of electricity in hydro and nuclear power plants comprises, as do network operations, an important part of the business, unlike the other operations that require permits. The generation of electricity in hydro power plants is mainly conducted within the parent company. Other operations of importance are run mainly within subsidiaries.

The main environmental impact of nuclear power plants is radioactive waste, while from combustion plants it is gaseous emissions of carbon dioxide and acidifying substances. The main environmental impact of hydro power and network operations is land use.

Corporate Social Responsibility report

Each year, Vattenfall publishes a Corporate Social Responsibility (CSR) report in accordance with the GRI (Global Reporting Initiative) guidelines. The aim of this report is to provide a balanced picture of Vattenfall's efforts as regards the environment, society and the economy. For more information, see page 31 of the Annual Report.

The parent company

The accounts of Vattenfall AB, the parent company, are prepared in accordance with Swedish GAAP, that is, in accordance with the Swedish Annual Accounts Act and the Swedish Financial Accounting Standards Council's recommendation (RR 32) on reporting for legal entities. The parent company does not apply IAS 39 – Financial Instruments, to the accounts for 2005. Sales amounted to SEK 26,843 million (26,046). Profit before appropriations and tax was SEK 6,167 million (11,502) and the profit for the year was SEK 3,585 million (7,035). Investments for the year amounted to SEK 13,052 million (3,671). Cash and cash equivalents amounted to SEK 2,360 million (142). Funds in the Group account managed by Vattenfall Treasury AB amounted to SEK 30,892 million (22,533).

The work of the Board of Directors in 2005

The Board of Directors establishes rules of procedure each year which, in essence, follow the guidelines issued by the Swedish Ministry of Industry, on 18 May 2000. During 2005, the Board met nine times, including the statutory meeting. The Board evaluates the work of the Board of Directors once a year. In 2003, the Board formed an internal Audit Committee, consisting of three Board members. The Audit Committee held four meetings in 2005. Vattenfall AB's auditors were present at all meetings to present, among other things, the auditing plan and their observations from the audit of the Group's internal control, the review of the six-month accounts and the audit of the annual accounts.

Outlook for 2006

The single most important factor affecting Vattenfall's financial performance is the electricity wholesale price. Wholesale prices rose steeply in 2005, particularly forward prices, which indicates continued high prices and therefore continued good earnings ability. Prices in the Nordic countries are chiefly affected by the water supply, which at the end of 2005 was just below normal level. As Vattenfall hedges future electricity generation to a considerable extent, the effect of fluctuating electricity wholesale prices on profits is evened out. In Sweden, the network regulator's application of the so-called network performance assessment model can lead to considerable income loss in electricity network operations and, consequently, insufficient return on investments in electricity networks. In Germany, uncertainty still surrounds the possible consequences of the new network regulation. According to current assessments, the new trading system for carbon dioxide emissions introduced in 2005 is not expected to have any negative impact on Vattenfall during the initial trading period (2005–2007).

Proposed distribution of profits

See page 112.

Events after the balance sheet date

- On 31 January, the Board of Directors decided to extend the depreciation period for the Swedish nuclear power plants from 25 to 40 years. This decision has no retroactive effect.
- In February, the Swedish network regulator, Elmarknadsinspektionen (EMI), ordered Vattenfall to repay SEK 236 million in network tariffs for 2003, a decision Vattenfall will appeal.
- In February, Vattenfall's Revolving Credit Facility was renegotiated and increased from EUR 600 million to EUR 1,000 million. The maturity was extended to 2013.

CONSOLIDATED INCOME STATEMENT

Amounts in SEK millions, 1 January–31 December	Note	2005	2004
Net sales	7, 8	129,158	113,366
Cost of products sold ¹	9	-93,636	-83,848
Gross profit		35,522	29,518
Other operating income	10	5,397	2,088
Selling expenses	11	-5,844	-4,905
Administrative expenses	11	-6,639	-7,138
Research and development costs	11	-651	-529
Other operating expenses	12	-748	-962
Participations in the results of associated companies	8	693	-960
Operating profit (EBIT)²	8, 13, 14, 15, 47, 48	27,730	17,112
Financial income ³	16	3,810	2,969
Financial expenses ⁴	17	-5,221	-5,467
Profit before tax⁵		26,319	14,614
Income tax expense	18	-5,801	-5,010
Profit for the year⁶		20,518	9,604
Attributable to			
Shareholders of the Parent Company		19,235	8,944
Minority interests	19	1,283	660
Total		20,518	9,604
Earnings per share			
Number of shares in Vattenfall AB, thousands		131,700	131,700
Earnings per share, SEK		146.05	67.91
Dividend, SEK millions		5,800 ⁷	5,600
Dividend per share, SEK		44.04 ⁷	42.52
Additional information:			
Operating profit before depreciation (EBITDA)		42,542	32,386
Net financial items excluding discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund		-1,440	-2,248
1) Of which depreciation, amortisation and impairment losses		-14,290	-14,745
2) Of which depreciation, amortisation and impairment losses		-14,812	-15,274
2) Including items affecting comparability attributable to:			
capital gains/losses		-71	819
restructuring costs		-	-3,034
closing of Barsebäck 2		3,057	-
3) Including discounting effects attributable to provisions		-	491
3) Including returns from the Swedish Nuclear Waste Fund		2,089	1,253
4) Including discounting effects attributable to provisions excl pension provisions		-2,060	-1,994
5) Including items affecting comparability		2,994	-2,217
6) Including items affecting comparability adjusted for tax		3,154	-1,305
7) Proposed dividend			

Comments

Net sales and financial performance

Net sales increased by 13.9 per cent to SEK 129,158 million (113,366). The increase is primarily due to higher electricity wholesale prices in Germany, somewhat higher sales volumes in the Nordic countries and Poland and exchange rate effects – stronger EUR and PLN. The sales figure does not include financial electricity trading.

The increase in cost of products sold of 11.7 per cent to SEK 93,636 million (83,848) is mainly due to increased costs for electricity and fuel purchases as well as increased operating and maintenance costs.

Depreciation decreased by 4.4 per cent to SEK 14,026 million (14,669). See Note 13 of the consolidated accounts.

The large increase in other operating income is primarily due to compensation from the Swedish state in the amount of SEK 4,100 million for future production losses due to the closure of Barsebäck 2 being carried as income.

Participations in the results of associated companies improved sharply to SEK 693 million (–960). This is primarily due to an improved participation in the 50%-owned German nuclear power plant Krümmel, the participation in the Danish company Elsam A/S and profit for 2004 being burdened with impairment losses of the shareholdings in GASAG Berliner Gaswerke AG and Städtische Werke Kassel AG.

Operating profit increased by 62.1 per cent to SEK 27,730 million (17,112). Excluding items affecting comparability, operating profit increased by 28.0 per cent to SEK 24,744 million (19,327). The improvement is explained by higher electricity wholesale prices, larger volumes in Nordic hydro power generation (+18%) and improved hedging outcomes (electricity generation hedges).

The various provisions made in the Vattenfall Group's balance sheet have been reviewed. This review has led to changes in earlier assumptions about discount rates in the calculation of these provisions. As a result, the Group's operating profit for 2005 has been burdened in the amount of SEK 650 million. See Note 50 of the consolidated account on page 103.

Net financial items amounted to SEK –1,411 million (–2,498), an improvement of 43.5 per cent. The improvement is mainly due to

increased income from Vattenfall's share in the Swedish Nuclear Waste Fund and lower interest rates on loans. Net interest items amounted to an average of SEK –166 million a month (–200). Interest income/expenses and received/paid interest break down as follows:

	2005	2004	% change
Interest income	980	1,030	–4,9
Interest expenses	2,967	3,431	–13,5
Interest received ¹	875	1,256	–30,3
Interest paid ¹	2,230	3,693	–39,6

¹) Affects cash flow

Income taxes increased by SEK 791 million to SEK 5,801 million (5,010). The effective tax rate, according to the income statement, amounted to 22.0 per cent (34.3). The improvement is primarily due to SEK 4,100 million in compensation for the closure of Barsebäck 2 not resulting in any tax expense, a reduction in deferred taxes and the reversal of tax attributable to profits from previous years, primarily in Germany.

Profit for the year increased by 113.6 per cent to SEK 20,518 million (9,604); excluding items affecting comparability by 59.2 per cent to SEK 17,364 million (10,909).

Return on equity increased to 26.4 per cent (13.7); excluding items affecting comparability to 22.0 per cent (15.6). Return on net assets increased to 18.0 per cent (11.6); excluding items affecting comparability to 15.9 per cent (13.3).

Segments

Group operations are divided into primary and secondary segments. Primary segments are the geographic areas Nordic Countries, Germany and Poland, and Other.

Secondary segments are the business areas Electricity Generation, Electricity Market, Electricity Networks, Heat and Other Operations. For the reporting of sales and operating profits for primary and secondary segments refer to Note 8 of the consolidated accounts. For comments on sales and operating profits as well as key ratios for the primary segments Nordic Countries, Germany and Poland, see pages 34–45.

CONSOLIDATED BALANCE SHEET

Amounts in SEK millions	Note	31 Dec 2005	31 Dec 2004
Assets	8		
Non-current assets			
Intangible assets	20	5,267	5,185
Property, plant and equipment	21	189,016	181,738
Investment property	22	1,256	1,280
Participations in associated companies	24	23,421	12,286
Other long-term securities holdings	25	747	2,448
Share in the Swedish Nuclear Waste Fund	26	21,403	19,447
Long-term receivables	27	4,285	7,756
Deferred tax assets	18	14,569	8,772
Total non-current assets		259,964	238,912
Current assets			
Inventories	28	12,667	7,577
Trade and other receivables	29	37,947	20,785
Prepaid expenses and accrued income	30	4,459	3,051
Current tax assets	18	1,310	1,264
Short-term investments	31	8,025	7,700
Cash and cash equivalents	32	6,049	5,916
Total current assets		70,457	46,293
Total assets		330,421	285,205
Equity and liabilities			
Equity attributable to shareholders of the parent company			
Share capital		6,585	6,585
Translation reserve		2,949	821
Hedging reserve		-10,388	-
Retained earnings incl profit for the year		78,976	65,588
Total equity attributable to shareholders of the parent company		78,122	72,994
Equity attributable to minority interests		10,344	10,114
Total equity		88,466	83,108
Non-current liabilities	8		
Capital Securities	33, 35	9,268	-
Other interest-bearing liabilities	34, 35	59,865	64,119
Interest-bearing provisions	36	42,976	40,621
Pension provisions	37	17,432	16,450
Deferred tax liabilities	18	42,370	41,646
Other non-interest-bearing liabilities	38	2,425	2,135
Total non-current liabilities		174,336	164,971
Current liabilities	8		
Trade and other liabilities	39	33,906	11,409
Accrued expenses and deferred income	40	17,393	9,954
Current tax liabilities	18	2,075	1,999
Interest-bearing liabilities	41	9,530	8,894
Interest-bearing provisions	36	4,715	4,870
Total current liabilities		67,619	37,126
Total equity and liabilities		330,421	285,205

See also information on the Group's pledged assets (Note 42), contingent liabilities (Note 43) and commitments under consortium agreements (Note 44).

Comments

Assets

Total non-current assets increased by 8.8 per cent or SEK 21,052 million to SEK 259,964 million (238,912) primarily due to the acquisition of 35.3 per cent of the shares in the Danish company Elsam A/S for SEK 10,325 million, which increased Participations in associated companies. Property, plant and equipment increased by approximately SEK 7,300 million due to investments. Share in the Swedish Nuclear Waste Fund increased by approximately SEK 2,000 million and deferred tax assets increased by approximately SEK 5,800 million, attributable to IAS 39, on financial instruments. Other long-term securities holdings decreased by approximately SEK 1,700 million, attributable to the former German associated company Koros GmbH & Co. KG being reported as a subsidiary as of the third quarter of 2005, the result of Vattenfall taking over the general partner function. (Koros owns approximately 5 per cent of the shares in Vattenfall Europe AG). Long-term receivables decreased by approximately SEK 3,500 million, the result of loan repayments from the minority owners of the German nuclear power plant Brunsbüttel.

Current assets increased by 52.2 per cent or SEK 24,164 million to SEK 70,457 million (46,293). Inventories increased by approximately SEK 5,100 million, chiefly attributable to received emission allowances for carbon dioxide (see Note 2 – Accounting Principles in the consolidated accounts, page 80). Trade and other receivables increased by approximately SEK 17,100 million, primarily attributable to derivative positions with positive fair values according to IAS 39 (SEK 9,467 million), receivables from the Swedish state attributable to the Barsebäck agreement (SEK 4,100 million) and a deposit of approximately SEK 2,400 million for the squeeze-out of shares in Vattenfall Europe AG.

Short-term investments plus cash and cash equivalents increased somewhat to a total of SEK 14,074 million (13,616), corresponding to 10.9 per cent (12.0) of sales. These assets include SEK 3,205 million (3,508) that comprise Vattenfall Europe AG's share of the liability insurance agreement (Solidarvereinbarung) between the German nuclear power plant operators for their commitment pursuant to the German Nuclear Liability Act. SEK 2,246 million comprises blocked funds as collateral for trading on energy exchanges.

In addition to short-term investments plus cash and cash equivalents of SEK 14,074 million, Vattenfall also had available, as of 31 December, SEK 17,752 million in committed credit facilities (5,606) and SEK 10,198 million (8,192) in uncommitted credit facilities.

In all, the balance sheet total increased by 15.9 per cent to SEK 330,421 million (285,205).

Equity and liabilities

Equity including minority interests, increased by 6.4 per cent to SEK 88,466 million (83,108). Equity attributable to shareholders of the parent company increased by 7.0 per cent while equity attributable to minority interests increased by 2.2 per cent. The equity/assets ratio increased to 26.8 per cent (29.1). Total provisions including deferred tax liabilities increased by 3.8 per cent to SEK 107,493 million (103,587). For further details, see Notes 18, 36 and 37 of the consolidated accounts.

Total interest-bearing liabilities increased by 7.7 per cent to SEK 78,663 million (73,013). This includes SEK 9,268 million of Capital Securities, issued in June 2005. The rating agencies treat the larger part of these Capital Securities as equity (Moody's 75 per cent and Standard & Poor's 60 per cent). Total interest-bearing liabilities also includes SEK 13,731 million (14,458) attributable to loans from Vattenfall's minority-owned German nuclear power companies. The interest rate on these loans was 1 per cent.

SEK 4,640 million (4,059) comprises loans from minority owners, in mainly Vattenfall's Swedish nuclear power plants. The Group's net debt increased by 16.1 per cent to SEK 64,343 million (55,411), primarily due to the acquisition of shares in the Danish power company Elsam A/S (SEK 10,325 million) and the distribution of dividend to the Swedish state (SEK 5,600 million). The net debt/equity ratio as of 31 December 2005 was 0.73, compared with 0.67 as of 31 December 2004. For further details of the breakdown of loans into various types, see Notes 33 and 34 of the consolidated accounts.

Additional information

Net assets

Amounts in SEK millions	31 Dec 2005	31 Dec 2004
Nordic Countries	77,190	57,377
Germany	68,717	68,040
Poland	9,295	7,321
Other ¹	-2,034	-3,409
Eliminations	2,069	2,293
Total net assets	155,237	131,622
Net assets, weighted average value	143,001	134,125

1) Includes energy trading, treasury activities and other Group functions.

Net debt

Amounts in SEK millions	31 Dec 2005	31 Dec 2004
Capital Securities	-9,268	-
Other interest-bearing liabilities ¹	-69,395	-73,013
Cash and cash equivalents	6,049	5,916
Short-term investments	8,025	7,700
Loans to minority owners in foreign subsidiaries	246	3,986
Total net debt	-64,343	-55,411

1) Of which loans from minority-owned German nuclear power companies

CONSOLIDATED CASH FLOW STATEMENT

Amounts in SEK millions, 1 January–31 December	2005	2004
Operating activities		
Funds from operations (FFO) ¹	31,386	24,302
Cash flow from changes in operating assets and operating liabilities	-6,963	-199
Cash flow from operating activities	24,423	24,103
Investment activities		
Investments ²	-24,497	-12,731
Divestments ³	785	2,120
Cash and cash equivalents in acquired/sold companies	17	-20
Cash flow from investment activities	-23,695	-10,631
Cash flow before financing activities	728	13,472
Financing activities		
Changes in short-term investments	-25	-439
Decrease in loans to minority owners in foreign subsidiaries	3,864	-
Loans raised	1,562	7,984
Amortisation of debt	-9,667	-20,229
Issue of Capital Securities	9,248	-
Dividend paid to shareholders	-5,778	-2,600
Cash flow from financing activities	-796	-15,284
Cash flow for the year	-68	-1,812
Cash and cash equivalents		
Cash and cash equivalents at the beginning of the year	5,916	7,301
Cash flow for the year	-68	-1,812
Exchange rate differences	201	427
Cash and cash equivalents at the end of the year	6,049	5,916
Additional information		
Cash flow before financing activities	728	13,472
Financing activities		
Dividend paid to shareholders	-5,778	-2,600
Cash flow after dividend	-5,050	10,872
Analysis of change in net debt		
Net debt at the beginning of the year	-55,411	-66,890
Transition effect on adoption of new accounting principles (IAS 39)	-584	-
Effect of altered classification of interest in pension provisions	-	84
Cash flow after dividend	-5,050	10,872
Changes as a result of valuation at fair value	-10	-
Exchange rate differences on net debt	-3,288	523
Net debt at the end of the year	-64,343	-55,411
Free cash flow	14,341	15,684

1, 2, 3) See page 73

Comments

Cash flow

Cash flow from operating activities increased by 1.3 per cent to SEK 24,423 million (24,103). Funds from operations (FFO) increased by 29.1 per cent to SEK 31,386 (24,302) while the change in working capital amounted to SEK -6,963 million (-199). The negative change in operating capital is primarily attributable to the compensation from the Swedish state of SEK 4,100 million for the closing of Barsebäck 2 being paid in the form of a promissory note and hence recorded as a receivable, and the deposit of approximately SEK 2,400 for the squeeze-out of shares in the German subsidiary Vattenfall Europe AG.

Free cash flow, that is, cash flow from operating activities less maintenance investments, decreased by 8.6 per cent to SEK 14,341 million (15,684). Cash flow before financing activities decreased by 94.6 per cent to SEK 728 million (13,472) due to increased maintenance investments and sharply increased growth investments, primarily the acquisition of shares in the Danish company Elsam A/S.

Investment activities

Total investments increased by 92.4 per cent to SEK 24,497 million (12,731).

Maintenance investments increased by 19.8 per cent to SEK 10,082 million (8,419) while growth investments increased by a full 234.3 per cent to SEK 14,415 million (4,312), of which shares totalled SEK 11,709 million (2,433). Growth investments are comprised to 81 per cent of shares, of which by far the greater part comprises the acquisition of 35.3 per cent of the shares in the Danish company Elsam A/S. The remainder is mainly comprised of the acquisition of additional shares in Vattenfall Europe AG, of which Vattenfall's direct and indirect ownership as of 31 December amounted to approximately 97 per cent, and the acquisition of two wind power companies for the development of the Lillgrund and Kriegers Flak wind power farms. For more information about Vattenfall's investments in 2005 and 2004, see the table on page 65.

Divested assets amounted to SEK 785 million (2,120), including SEK 397 (1,216) in shares. The divested shares primarily comprised holdings in a number of smaller companies in Sweden and German outside core operations. See Note 5 of the consolidated accounts, page 85.

Financing activities

Total interest-bearing liabilities, including Capital Securities, increased by 7.7 per cent to SEK 78,663 million (73,013). Excluding Capital Securities of SEK 9,268 interest-bearing liabilities decreased by 5.0 per cent. The rating agencies treat the larger part of these Capital Securities as equity (Moody's 75 per cent and Standard & Poor's 60 per cent). For more information about Capital Securities, see Note 33 of the consolidated accounts, page 95.

Net debt increased by 16.1 per cent to SEK 64,343 million (55,411).

As of 31 December, the average duration was 3.4 years (2.0) and the average remaining maturity for net debt was 6.6 years (6.7). Excluding Capital Securities, the average duration was 2.5 years and the average maturity was 6.0 years. All public funding is conducted through Vattenfall Treasury AB guaranteed by Vattenfall AB.

1) Funds from operations (FFO)

Amounts in SEK millions	2005	2004
Profit for the year	20,518	9,604
Depreciation, amortisation and impairment losses	14,812	15,274
Undistributed results from participations in associated companies	-121	1,327
Unrealised items related to derivatives	-1,154	-
Unrealised foreign exchange gains	-694	-259
Unrealised foreign exchange losses	804	159
Capital gains	-403	-1,033
Capital losses	467	166
Reversed impairment losses	13	22
Change in interest receivables	-306	56
Change in interest liabilities	896	-119
Change in tax liabilities	-52	2,038
Change in the Swedish Nuclear Waste Fund	-1,956	-880
Change in provisions	-1,438	-2,053
Total	31,386	24,302

Interest paid totalled SEK 2,230 million (3,693) and interest received totalled SEK 875 million (1,256). Tax paid totalled SEK 5,853 million (2,972).

2) Investments

Amounts in SEK millions	2005	2004
Acquisitions of Group companies	1,384	2,433
Investments in associated companies and other long-term securities holdings	10,344	2
Investments in property, plant and equipment	12,164	9,852
Investments in intangible assets	602	435
Investments in investment property	3	9
Total	24,497	12,731

3) Divestments

Amounts in SEK millions	2005	2004
Divestments of property, plant and equipment and intangible assets	388	904
Divestments of shares and participations	397	1,216
Total	785	2,120

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Amounts in SEK millions	Attributable to shareholders of the parent company					Attributable to minority interests	Total equity
	Share capital	Translation reserve	Hedging reserve	Retained earnings incl profit for year	Total		
Balance brought forward 2004	6,585	–	–	58,917	65,502	10,227	75,729
Hedging of net investments in foreign operations	–	332	–	–	332	–	332
Translation differences	–	489	–	127	616	251	867
Total changes reported directly against equity excl transactions with the company's owners	0	821	0	127	948	251	1,199
Profit for the year	–	–	–	8,944	8,944	660	9,604
Total changes excl transactions with the company's owners	0	821	0	9,071	9,892	911	10,803
Dividend to shareholders	–	–	–	–2,400	–2,400	–200	–2,600
Group contributions from minority, after tax	–	–	–	–	–	192	192
Changes in ownership	–	–	–	–	–	–1,016	–1,016
Balance carried forward 2004	6,585	821	0	65,588	72,994	10,114	83,108
Transition effect on adoption of new accounting principles (IAS 39)	–	2	–264	–154	–416	–24	–440
Cash flow hedges:							
Reported directly against equity	–	–	–14,174	–	–14,174	–226	–14,400
Dissolved against income statement	–	–	–936	–	–936	–	–936
Transferred to cost of hedged item	–	–	–277	–	–277	–	–277
Tax attributable to items reported directly against equity	–	–	5,263	–	5,263	110	5,373
Hedging of net investments in foreign operations	–	–1,639	–	–	–1,639	–	–1,639
Translation differences	–	3,765	–	–	3,765	291	4,056
Total changes reported directly against equity, excl transactions with the company's owners	0	2,126	–10,124	0	–7,998	175	–7,823
Profit for the year	–	–	–	19,235	19,235	1,283	20,518
Total changes excl transactions with the company's owners	0	2,126	–10,124	19,235	11,237	1,458	12,695
Dividend to shareholders	–	–	–	–5,600	–5,600	–178	–5,778
Group contributions to minority, after tax	–	–	–	–	–	–119	–119
Changes in ownership	–	–	–	–	–	–1,000	–1,000
Transfers within equity	–	–	–	–93	–93	93	0
Balance carried forward 2005	6,585	2,949	–10,388	78,976	78,122	10,344	88,466

Share capital:

As of 31 December 2005 the registered share capital comprised 131,700,000 shares at a par value of SEK 50 each.

Translation reserve:

The translation reserve includes all exchange rate differences arising in the translation of financial reports from non-Swedish operations that prepare their reports in a currency other than that in which the Group reports, which is Swedish kronor (SEK). Further, the translation reserve includes exchange rate differences arising in the reassessment of debts raised as hedges for net investments in non-Swedish operations.

Hedging reserve:

The hedging reserve includes mostly unrealised values of electricity derivatives used to hedge future sales. The change during 2005 is mainly due to increased electricity wholesale prices during 2005.

Retained earnings including profit for the year:

Retained earnings including profit for the year includes earned profits in the parent company and its subsidiaries, associated companies and joint ventures. Earlier transfers to statutory reserves and other previously named restricted reserves are included in this equity item.

NOTES TO THE CONSOLIDATED ACCOUNTS

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Note 1 Company information

The consolidated accounts and year-end report for Vattenfall AB for 2005 have been approved for publication in accordance with a decision by the Board of Directors of 7 February 2006. The Annual Report has been approved in accordance with a decision by the Board of Directors of 22 February 2006. The parent company, Vattenfall AB, is a limited liability company with its registered office in Stockholm and with the address SE-162 87 Stockholm, Sweden. The consolidated balance sheet and income statement will be adopted at the annual general meeting (AGM).

The main activities of the Group are described in Note 8 of the consolidated accounts, Information on segments.

Note 2 Accounting principles

Conformity with standards and regulations

The consolidated accounts have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as well as the statements of interpretation issued by the International Financial Reporting Interpretations Committee (IFRIC) as approved by the European Commission for application within the EU. Also included are the International Accounting Standards (IAS) issued by IASB's predecessor the International Accounting Standards Committee (IASC) and the interpretive statements of interpretation issued by IFRIC's predecessor the Standing Interpretations Committee (SIC).

This financial report is the Vattenfall Group's first complete financial report to have been prepared in accordance with IFRS. In conjunction with the transition from previously applied accounting principles to reporting in accordance with IFRS, the Group has adopted IFRS 1 – First-time Adoption of IFRS, which is the standard that describes how the transition to IFRS should be reported. Comparative figures for the year 2004 have been restated in accordance with the new principles, with the exception of the figures for financial instruments. In accordance with the regulations for the transition to IFRS, the new principles are only applied to financial assets and liabilities (IAS 39 – Financial Instruments: Recognition and Measurement) in those parts of the accounts that concern 2005.

Further, the Swedish Financial Accounting Standards Council's recommendation RR 30 – Supplementary Accounting Principles for Groups of Companies, has been applied. RR 30 specifies the necessary additions to the IFRS disclosure requirements in accordance with the Swedish Annual Accounts Act.

The effects of the transition from previously applied accounting principles (Swedish GAAP) to IFRS are reported in Note 3 of the consolidated accounts. The same Note contains a description of the exceptions to the rules permitted in accordance with IFRS 1 for retroactive application and which have been employed in the consolidated accounts.

The effects of the introduction of IAS 39 as of 1 January 2005, which are reported as changes in accounting principles, are specified in Note 4 of the consolidated accounts.

Conditions in connection with the preparation of the consolidated financial statements

The Parent Company's functional currency is Swedish krona which is also the reporting currency of both the Parent Company and the Group. This means that the financial statements are presented in Swedish krona (SEK). Unless otherwise stated, all figures are rounded off to the nearest million Swedish krona (MSEK).

Assets and liabilities are reported at cost, with the exception of assets and liabilities that are valued at fair value. Financial assets and liabilities valued at fair value consist of derivative instruments and financial assets that are valued at fair value through the income statement.

Preparation of the financial statements in accordance with IFRS

requires the Company's executive management and Board of Directors to make assessments and estimations as well as make assumptions that affect the application of the accounting principles and the reported amounts of assets, liabilities, income and expenses. The estimations and assumptions are based on historic experience and a number of other factors that seem reasonable under current conditions. The results of these estimations and assumptions are then used to establish the reported values of assets and liabilities which are not clearly documented from other sources. The final outcome can deviate from the results of these estimations and assessments.

The estimations and assumptions are revised regularly. The effects of changes in estimations are reported in the period in which the changes were made if the changes affected this period only, or in the period the changes were made and future periods if the changes affect both the current period and future periods.

When applying IFRS, assessments made by the Company's executive management and Board of Directors which have a significant effect on the financial statements and estimations made that may result in substantial adjustments to the following year's financial statements are described in greater detail in Note 50.

The accounting principles of the Group detailed below have been applied consistently to all periods presented in the consolidated financial statements and when preparing the consolidated opening balance sheet in accordance with IFRS as of 1 January 2004 which explains the transition from previously applied accounting principles in accordance with Swedish GAAP to accounting principles in accordance with IFRS. The Group's accounting principles have been applied consistently to the reporting and consolidation of subsidiaries and associated companies.

New or revised IFRS applied in advance during 2005

The following interpretation of IFRS has been applied in advance to the consolidated accounts for 2005:

According to IFRIC 5 – Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds, funds that are consolidated for future decommissioning and disassembly expenses must be reported as an asset in the balance sheet. Comparative figures for previous years have been restated.

Information on segments

In the accounts, a segment is an identifiable part of the Group which either provides products and services (business segments), or products and services in a certain economic environment (geographical area) that are exposed to risks and opportunities that distinguish it from other segments. Information on segments (see Note 8 of the consolidated accounts) is provided for the Group. Compared with the segments that were reported in Vattenfall's Annual Report for 2004, the segments from 2005 were altered to reflect changes in the internal organisation and management structure as well as reporting. Comparative figures for both primary and secondary segments in this Annual Report have been adjusted.

Classification of current and non-current assets and liabilities

An asset is classified as a current asset when it is held primarily for commercial purposes or is expected to be realised within twelve months after the balance sheet date or consists of cash and cash equivalents, provided it is not subject to restrictions on its exchange or use for regulating a liability at least twelve months after the balance sheet date.

All other assets are classified as non-current assets.

A liability is classified as a current liability when it is held primarily for commercial purposes or is expected to be settled within twelve months after the balance sheet date or that the Group does not have an unconditional right to defer settlement of the liability for a minimum of twelve months after the balance sheet date.

All other liabilities are classified as non-current liabilities.

Consolidation principles**Subsidiaries**

Subsidiaries are companies in which the Parent Company, Vattenfall AB, directly or indirectly holds more than 50 per cent of the voting power, or in any other way has a controlling influence. Controlling influence entails a right to design a company's financial and operational strategies with the purpose of gaining financial advantages.

Business combinations are accounted for by using the purchase method. This method means that the acquisition of a subsidiary is considered a transaction through which the Group indirectly acquires the subsidiary's assets and takes over its liabilities and contingent liabilities. Through acquisition analysis of the business acquisition, the acquisition value of the participating interests or business activities is established as well as the fair value of acquired identifiable assets and assumed liabilities and contingent liabilities. Deferred tax is taken into account in the surplus values. The difference between the acquisition value of the subsidiaries' shares and the fair value of acquired assets, assumed liabilities and contingent liabilities constitutes consolidated goodwill.

In a situation where a subsidiary is acquired in several stages, an acquisition analysis is also prepared for each acquisition transaction that takes place before a controlling influence is obtained. The reported value of goodwill is the sum total of the goodwill values calculated for each sub-acquisition.

The subsidiary's financial statements, which are prepared in accordance with the Group's accounting principles, are included in the consolidated accounts from the point of acquisition to the date when the controlling influence ceases.

A wound up operation is reported separately from remaining operations if the wound up operation comes to a significant amount.

Associated companies

Associated companies are the companies for which the Group has a significant – but not controlling – influence on their operational and financial management, usually through shareholdings of between 20 and 50% of the votes. From the point at which the significant influence is acquired, participations in associated companies are reported in the consolidated accounts in accordance with the equity method. The equity method means that the value of the shareholding in associated companies reported in the consolidated accounts corresponds to the Group's proportion of the associated companies' equity plus consolidated goodwill and any unamortised value of consolidated surplus and under values. In the consolidated income statement, the consolidated proportion of the associated company's reported profit after financial items, where appropriate adjusted for any amortisation, impairment loss or dissolution of acquired surplus or under values, is reported as "Participations in the results of associated companies". The Group's share of associated companies' recorded tax expenses is included in the consolidated tax expenses. Dividends received from the associated company reduce the book value of the investment.

In conjunction with the acquisition of an associated company, an acquisition analysis similar to that of a business combination is made. Identifiable surplus values are handled in a similar manner to surplus values in business combinations. If the associated company's reported losses exceed the reported value of the participations in the Group, the value of the participating interest will be reduced to zero. A deduction for losses will also be made for receivables without security which, in economic reality, form part of the owner company's net investments in the associated company. Excess losses are not reported provided the Group has not issued guarantees to cover losses arising in the associated company. The equity method is applied up to the point when the significant influence ceases.

Joint ventures

In the accounts, joint ventures are the activities for which the Group has a joint controlling influence on the operational and financial man-

agement through collaborative agreement with one or more parties. In the consolidated accounts, holdings in joint ventures are consolidated in accordance with the equity method.

Transactions that are eliminated on consolidation

Intra-group receivables and liabilities, income and expenses, as well as gains or losses arising from intra-group transactions between Group companies, are eliminated in their entirety when preparing the consolidated accounts.

Gains arising from transactions with associated companies and joint ventures are eliminated to an extent that corresponds to the Group's holding in the company. Losses are eliminated in the same manner as gains but only if there is no indication of any need for impairment.

Foreign currencies**Transactions in foreign currencies**

The functional currency is the currency of the primary economic environment in which each entity operates.

Transactions in foreign currencies are translated into the functional currency at the exchange rate on the day of the transaction. On the balance sheet date, monetary assets and liabilities in foreign currencies are translated into the functional currency at the exchange rate applicable on that day. Exchange rate differences arising from translation of currencies are reported in the income statement. Non-monetary assets and liabilities are reported at cost.

Financial reporting of foreign activities

Assets and liabilities of foreign activities, including goodwill and other consolidated surplus and under values, are translated into SEK at the exchange rate current on the balance sheet date. Income and expenses of foreign activities are translated into SEK with an average exchange rate which is an approximation of the rates at the time of each transaction. Translation differences arising from foreign currency translation of foreign activities are reported directly against equity under the heading Translation reserve.

Net investments in foreign activities

Effects of hedging of net investments in foreign activities are reported directly in the translation reserve in equity.

When divesting foreign activities, accumulated translation differences attributable to activities less any hedging are recognised in the consolidated income statement.

For the Vattenfall Group, the more important exchange rates used in the accounts are provided in Note 6 of the consolidated accounts.

Revenue recognition**Sales of goods and execution of service assignments**

Net sales include sales proceeds from ordinary activities. Operating revenues are reported at the time of delivery, excluding value-added tax and selective taxes.

In the case of service and consulting assignments, the percentage of completion method is applied, that is, revenues and expenses are reported in relation to the degree of completion. The degree of completion is established according to the relation between accrued expenses on the balance sheet date and estimated total expenses. In those cases where losses are expected a provision is established immediately.

Rental revenues

Rental revenues are reported on a straight-line basis over the period of the agreement in the income statement.

Government grants**General**

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.

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Note 2 continued

A grant tied to a fixed asset reduces the book value of the asset.

A grant intended to cover expenses is reported in the income statement as income over the same periods as the expenses.

Emission allowances

Emission allowances received, or purchased, from the authorities in each country at a value lower than fair value are reported at the time of purchase at fair value as a government grant and inventory asset in the balance sheet. The government grant is realised to income over the year and as carbon dioxide is emitted an expense and a liability for the obligation to provide emission allowances are recognised. The liability is valued on the basis of inventory assets (see further description of Emission allowances under the heading Inventories below).

Operating expenses

Leasing

Leasing is classified as either financial or operational leasing. Financial leasing exists when the economic risks and benefits associated with ownership are, in essence, transferred to the lessee. If this is not the case, the agreement is classified as operational leasing.

Payments concerning financial leasing agreements

Minimum leasing charges are distributed between interest expense and amortisation of the outstanding debt. Interest expenses are distributed over the leasing period so that each accounting period is burdened in the amount corresponding to a fixed interest rate for the reported debt in each period. Variable fees are carried as an expense in the period in which they arise.

Payments concerning operational leasing agreements

Payments concerning operational leasing agreements are reported in the income statement on a straight-line basis over the leasing period.

Financial income and expenses

Financial income

Financial income consists of interest income on bank balances, receivables and interest-bearing securities, returns from the Swedish Nuclear Waste Fund, dividend income, exchange rate differences, unrealised as well as realised gains on financial investments and derivative instruments used in financial activities.

Interest income includes accrued amounts of transaction costs and any rebates, premiums and other differences between the original value of the receivable and the amount received when due. Interest income is reported as it is earned. The calculation is made on the basis of the return on underlying assets in accordance with the effective rate method.

Dividend income is reported when the right to receive income is established.

Financial expenses

Financial expenses consist of interest expenses on loans, discounting effects attributable to provisions excluding provisions for pensions, exchange rate differences, unrealised as well as realised losses on financial investments and derivative instruments used in the financial activities. Discounting effects are defined here as the periodic change of the present value which reflects that the due date is approaching.

Issue expenses and similar direct transaction costs for raising loans are distributed over the term of the loan in accordance with the effective rate method.

Borrowing costs directly attributable to investment projects in fixed assets are not reported as financial costs but should be included in the cost of the fixed asset during the construction period.

Financial assets and liabilities

General principles

From 1 January 2005 the company reports all financial assets and liabilities in accordance with IAS 39 – Financial instruments: Recognition and Measurement, the content of which is described below. Comparative figures for the previous year have not been restated in accordance with IAS 39.

For a detailed description of the accounting principles applied to financial assets and liabilities in the previous year, please refer to Note 2 of the consolidated accounts of Vattenfall's Annual Report for 2004.

Foreign exchange gains and losses concerning operations-related receivables and liabilities in foreign currencies are reported under operating profit, while foreign exchange gains and losses concerning other receivables and liabilities in foreign currencies are reported under net financial items.

For financial instruments traded on organised financial markets, the fair value is fixed at the rate applicable when the market closes on the balance sheet date. For unlisted financial instruments, fair value is fixed by discounting estimated future cash flow.

Financial assets

Financial assets are classified into various categories depending on the purpose of the acquisition of the financial asset. The classification is determined at the original acquisition time.

Settlement day accounting is applied to spot purchases and spot sales of financial assets.

Financial assets valued at fair value through the income statement

In this category, assets are classified as holdings for commercial purposes which means that the aim is for them to be divested in the short term. Derivative instruments are always classified in this category, apart from instances when they are classified as a hedge, when hedging is applied (see below). Assets are revalued on an ongoing basis at fair value with changes in value reported in the income statement.

This category includes cash and cash equivalents as well as immediately available credit balances with banks and similar institutions as well as cash equivalents with an original term of less than three months. The category also includes short-term investments with original terms exceeding three months.

Loans receivable and trade receivables

Loans receivable and trade receivables are financial assets with fixed payments or payments that can be fixed at amounts. Receivables arise when the company provides money, goods and services directly to the debtor without the intention of doing business in the right of action. Acquired receivables are also covered. A valuation is made at amortised cost. Amortised cost is defined as the value at which a financial asset or liability is valued when it is initially recorded in the balance sheet, less any repayments, and with additions or deductions for the distribution over time of any differences between the amount initially recognised and the repayment amount.

Trade receivables are reported at the amount expected to be paid, less bad debts which are assessed individually. Impairment losses of trade receivables are reported under operating expenses. Trade receivables have a short anticipated term and are therefore valued at a nominal amount without discounting.

Other long-term securities holdings

Defined as shares and participations for which there are no balance sheet date quotations and for which a fair value cannot be established. A valuation is made at cost, in certain cases after taking accumulated impairment losses into account.

Financial liabilities

In accordance with IAS 39, the Company's financial liabilities have been classified into various categories depending on the purpose of

the acquisition of the financial asset. The classification is determined at the original acquisition time.

Financial liabilities valued at fair value through the income statement

Derivative instruments classified in this category, apart from instances when they are classified as a hedge, when hedging is applied (see below). Valuation is conducted on a continual basis at fair value with changes in value reported in the income statement.

Other financial liabilities

In this category, interest-bearing and non interest-bearing financial liabilities that are not held for commercial purposes are reported. A valuation is made amortised cost.

Non-current liabilities have a remaining term of more than one year, while liabilities with shorter terms are reported as current.

Trade liabilities have a short anticipated term and are therefore valued at a nominal amount without discounting.

Liabilities included in a hedge relationship are reported in accordance with the principles described below.

Derivative instruments and hedging

The Company uses various types of derivative instruments (forwards, futures and swaps) to hedge various financial risks, primarily interest rate risks, currency risks and electricity price risks.

Derivative instruments with a positive market value are reported in the balance sheet under the item Trade and other receivables, while derivative instruments with a negative market value are reported under the item Trade and other liabilities.

Derivative instruments are reported at fair value on the balance sheet date. Changes in value are reported in various ways depending on whether the derivative instrument is classified as a hedge or not. The main rule is that a change in value is reported in the income statement in the period in which it arises. Based on the purpose of the contract, changes in value are reported either under operating profit or as financial income/expense.

Hedging is adopted for derivative instruments that are included in a documented hedge relationship. For hedging to be applied, an unambiguous connection between the hedge and the hedged item is required. Further, it is necessary for the hedge to protect the risk effectively as intended, that the effectiveness of the measure can be demonstrated at all times to be sufficiently high through effectiveness testing and that hedging documentation has been prepared. How changes in value are reported in these cases depends on the type of hedge entered into.

Cash flow hedges

For derivative instruments that constitute hedges in a cash flow hedge, the effective part of the change in value is reported under equity while the ineffective part is reported directly in the income statement. That part of the change in value that is reported under equity is then transferred to the income statement for the period when the hedged item affects the income statement. In those cases where the hedged item refers to a future transaction, which is later capitalised as a non-financial asset or liability in the balance sheet (for example, when hedging future purchases of non-current assets in a foreign currency), that part of the change in value reported under equity is transferred to and included in the cost value of the asset or liability.

If the conditions for hedging are no longer met, the accumulated changes in value that were reported under equity are transferred to the income statement for the later period when the hedged item affects the income statement. Changes in value from the day on which the conditions for hedging ceased to be met are reported directly in the income statement. If the hedged transaction is no longer expected to occur, the hedge's accumulated changes in value are immediately transferred from equity to the income statement.

Cash flow hedges are used primarily in the following cases: i) when

forward electricity contracts are used to hedge electricity price risk in future purchases and sales, ii) when forward exchange rate contracts are used to hedge currency risk in future purchases and sales in foreign currencies, and iii) when interest rate swaps are used to replace borrowing at a floating interest rate with a fixed interest rate.

Hedges of fair value

For hedges of fair value, the hedge is reported at fair value with changes in value directly in the income statement while gains or losses on the hedged item, which are attributable to the hedged risk, adjust the reported value of the hedged item and are reported in the income statement.

A hedge of fair value is primarily used in cases where interest rate swaps are used for hedging interest rate risk on borrowings at a fixed interest rate.

Hedges of net investments

For derivative instruments and loans in foreign currencies that constitute hedges in hedging of net investments, the effective part of the change in value is reported under equity while the ineffective part is reported directly in the income statement. The changes in value reported under equity are transferred to the income statement at a later stage when the foreign activity is divested.

Hedging of net investments is primarily used when forward exchange rate contracts and loans in foreign currencies are used to hedge the currency risk of the company's investments in foreign subsidiaries.

Intangible assets

Capitalised development costs

Development costs, resulting from the application of research findings or other knowledge to produce new or improved products or processes, are reported as an asset in the balance sheet from the time when the product or process is expected to become technically and commercially usable and the company has sufficient resources to complete the development work and subsequently use or sell the intangible assets. The reported value includes costs for materials, direct costs for salaries and indirect costs all of which can be attributed to assets. Other development costs are reported in the income statement as expenses when they arise. In the balance sheet, development costs are reported at cost less accumulated amortisation and impairment losses.

Research costs with the purpose of obtaining new scientific or technical knowledge are reported as expenses when they arise.

Goodwill

Goodwill represents the difference between the acquisition value of a business combination and the fair value at the point of acquisition of acquired assets, assumed liabilities and contingent liabilities. The difference is the cost of goodwill.

Goodwill is valued at cost less any accumulated impairment losses. Goodwill is not subject to amortisation but is tested annually for impairment. Goodwill that arises on acquisition of associated companies is included in the reported value of Participations in associated companies.

Other intangible assets

Other intangible assets such as concessions, patents, licences, trademarks and similar rights as well as renting rights, mining rights and similar rights acquired by the Group are reported at cost less accumulated amortisation and impairment losses.

Subsequent costs

Subsequent costs for capitalised intangible assets are only reported as an asset in the balance sheet when they increase the future financial advantages for the specific assets to which they refer. All other costs are carried as an expense when they arise.

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Note 2 continued

Principles for amortisation

Amortisation is reported on a straight-line basis in the income statement over the estimated useful life of the asset, provided the useful life not is indefinite. Estimated useful lives:

Capitalised development costs	3–4 years
Concessions, patents, licences, etc	3–30 years
Renting rights, mining rights etc	3–50 years

Assessments of the residual value and useful life of an asset are conducted annually.

Property, plant and equipment

Owned assets

Property, plant and equipment are reported as assets in the balance sheet if it is likely that there will be future financial benefit for the company and the cost of the asset can be calculated in a reliable manner.

Assets reported as property, plant and equipment are land and buildings, plant and machinery as well as equipment, tools and fixtures and fittings. These assets are valued at cost less accumulated depreciation and impairment losses.

Cost includes the purchase price and costs directly attributable to putting the asset in place and in a suitable condition for use in accordance with the purpose of the acquisition. Examples of directly attributable expenses included in cost are delivery and handling, installation, land registration and consulting services. Borrowing costs directly attributable to investment projects in property, plant and equipment are included in cost of the asset during the construction period.

Within nuclear power operations in Germany and Sweden, cost at the time of acquisition includes a calculated present value for estimated costs for decommissioning and removing the plant and restoring the site where the plant is located. Further, this obligation also encompasses the safeguarding and final storage of spent radioactive materials used by the plants.

Similarly, for mining operations in Germany, cost at the time of the acquisition includes a calculated present value for estimated costs for undertaking to restore the land.

The equivalent estimated cost calculated on the basis of the present value is reported initially as a provision.

Leasing

Leasing is classified as either financial or operational leasing. Financial leasing exists when the economic risks and benefits associated with ownership are, in essence, transferred to the lessee; if this is not the case, it is classified as operational leasing.

Leased assets

Assets leased under financial leasing agreements are reported as assets in the consolidated balance sheet. A commitment to pay future leasing charges is reported as a non-current or current liability. The leased assets are depreciated on a straight-line basis over the shorter leasing period or useful life while the leasing payments are reported as interest and amortisation of the debts.

Operational leasing normally entails the leasing charge being carried as an expense on a straight-line basis over the leasing period.

Hired out assets

Assets that are hired out under financial leasing agreements are not reported as property, plant and equipment as the risks associated with ownership are transferred to the lessee. Instead, a financial receivable is entered for the future minimum leasing charges.

Assets hired out under operational leasing agreements are reported as property, plant and equipment that are subject to depreciation.

Subsequent costs

Subsequent cost are only added to cost if it is likely that there will be future financial benefits associated with the asset for the company and the cost can be calculated in a reliable manner. All other future costs are reported as expenses in the period when they arise.

When a subsequent cost is added to cost it is crucial for the assessment if the cost concerns the replacement of identified components, or parts of them, at which costs of this kind are capitalised. Also in those cases where new components are created, the cost is added to cost of the asset. Any undepreciated reported value of replacement components, or parts of components, are discarded and carried as an expense in connection with the replacement. Repairs are carried as an expense continuously.

Depreciation principles

Depreciation is made on a straight-line basis to the calculated residual value over the estimated useful life of the asset. The Group applies component depreciation which means that the components' estimated useful life provides the basis for the depreciation.

Estimated useful lives:

Hydro power installations	5–40 years
District heating installations	5–30 years
Electricity distribution and transmission lines	5–35 years
Mining operations	5–20 years
Office equipment	5–10 years
Office and warehouse buildings and workshops	25–50 years

Assessments of the residual value and useful life of an asset are conducted annually.

Land and water rights are not subject to depreciation.

Investment property

Investment property is property held in order to earn rental income or an increase in value or a combination of these two objectives.

Investment property is reported in the balance sheet at cost less accumulated depreciation and impairment losses. Depreciation is made on a straight-line basis and an assessment of residual value and useful life of an asset are conducted annually.

Estimated useful lives for investment property is 25–50 years.

Inventories

Nuclear fuel, oil, coal, materials and spare parts

These inventories are valued at the lowest of cost and the net realisable value. The net realisable value is the estimated sales price in operating activities, less estimated costs for completion and to bring about a sale.

The consumption of nuclear fuel is calculated as a depletion of the energy content of the fuel rods, and is based on the cost of each batch of fuel loaded into the core.

The cost of inventories is estimated through the application of the first-in first-out method (FIFO) and includes costs that arose on acquisition of the inventory items.

The value of the energy stored in the form of water in reservoirs is not reported as an asset.

Emission allowances

As of 2005, a trading system applies in the EU with the purpose of reducing emissions of the greenhouse gas carbon dioxide. Within the framework of this system, concerned plants have received, without payment or for prices below fair value, so-called emission allowances from the authorities in each country.

Received and purchased emission allowances are reported as inventories (see also description of Emission allowances under the heading Government grants above).

Impairment losses

Assessments are made throughout the year for any indication that an asset (with the exception of inventories and deferred tax assets) may have fallen in value. If there is an indication of this kind, the asset's recoverable amount is estimated. For goodwill and other intangible assets with indefinite useful life and for intangible assets which are still not ready for use, the recoverable amount is calculated annually.

If the essentially independent cash flow to an individual asset cannot be established, on assessment of any need for impairment, the assets must be grouped at the lowest level where it is possible to identify the essentially independent cash flow (a so-called cash-generating unit). An impairment loss is reported when an asset or cash-generating unit's reported value exceeds the recoverable amount. An impairment loss is recognised in the income statement.

Impairment of assets attributable to a cash-generating unit is allocated primarily to goodwill. Thereafter, a proportional impairment loss is conducted of other assets that are part of the unit.

Calculation of the recoverable amount

The recoverable amount is the highest fair value less selling expenses and the value in use. When calculating the value in use, the future cash flow is discounted by a discounting factor which takes into consideration risk-free interest and the risk associated with the specific asset. For an asset that does not generate cash flow independently of other assets, the recoverable amount is calculated for the cash-generating unit to which the asset belongs.

Reversal of impairment losses

Impairment losses of financial assets that are reported at amortised cost are reversed if a later increase of the recoverable amount can be attributed to an event that occurred after the impairment loss was done.

Impairment losses on goodwill are never reversed.

Impairment losses on other assets are reversed if a change has occurred to the assumptions that formed the basis for the calculation of the recoverable amount.

An impairment loss is only reversed if the asset's reported value after reversal does not exceed the reported value that the asset would have had if the impairment loss had not been done.

Capital Securities

Capital Securities are reported as interest-bearing non-current liabilities as the intention is for the loan to be repaid. See also Note 33 of the consolidated accounts.

Employee benefits**Defined contribution pension plans**

Defined contribution pension plans are plans for benefits following completion of employment according to which fixed fees are paid to a separate legal unit. There is no legal or informal obligation to pay additional fees if the legal unit does not have sufficient assets to pay all remuneration to the employees. Obligations concerning fees for defined contribution pension plans are reported as an expense in the income statement when they occur.

Defined benefit pension plans

Defined benefit pension plans are plans for remuneration following completion of employment other than defined contribution pension plans. The Group's obligations concerning defined benefit pension plans are calculated separately for each plan in accordance with the so-called Projected Unit Credit Method by calculating the remuneration the employees earned through their employment in both current and earlier periods. Estimated future salary adjustments are taken into consideration. The net obligation comprises discounted present value of the total earned and calculated future remuneration minus the fair value of any plan assets. The discount rate is the inter-

est on the balance sheet date by reference to first-class corporate obligation 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 remunerations in a plan are improved, the proportion of the increased remuneration which is attributable to the employees' service during earlier periods is reported as an expense in the income statement on a straight-line basis distributed over the average period until the remunerations are wholly earned. If the remuneration is 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 means that that part of the accumulated actuarial gains and losses that exceed 10% of the largest of the obligations' present value and the fair value plan assets' and is reported in the income statement starting the year after they arise over the expected average remaining service period for the employees covered by the plan. Otherwise, actuarial gains and losses are not taken into account.

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 costs for service during earlier periods and the present value of future repayments from the plan or reduced future payments to the plan.

Reporting of a provision or receivable is effected in the consolidated accounts for personnel-related fees based on differences in reporting for a legal entity and the corresponding reporting for the Group.

Other provisions than provisions for pensions

A provision is reported in the balance sheet when the Group has a legal or informal obligation as a result of an event and it is probable that an outflow of financial resources will be required to regulate the obligation and a reliable estimate of the amount can be made. Where the effect of the time when payment is made is important, provisions are estimated by discounting the anticipated future cash flow at an interest rate before tax which reflects current market estimates of money's time value and the risks associated with the liability. The discount rate does not reflect such risks as are taken into consideration in the estimated future cash flow.

Income tax expense

Income tax comprises current tax and deferred tax. Income tax is reported in the income statement except when the underlying transaction is reported directly against equity, at which the associated tax effect is reported under equity.

Current tax is tax to be paid or received for the current year, with the application of the tax rates that are passed or, in practice, passed as of the balance sheet date. Adjustments of tax paid attributable to previous periods are also included in this.

Deferred tax is calculated in accordance with the balance sheet method on the basis of temporary differences between the reported and taxable values of assets and liabilities. The following temporary differences are not taken into account: for a temporary difference that arises with the first reporting of goodwill, first reporting of assets and liabilities which are not business combinations and at the time of the transaction do not affect either reported or taxable profit. Further, such temporary differences attributable to shares or participations in subsidiaries or associated companies which are not expected to be reversed in the foreseeable future are not taken into account either. The valuation of deferred tax is based on how the reported value of assets or liabilities is expected to be realised or settled. Deferred tax is calculated in accordance with the tax rates and tax rules passed or, in practice, passed by the balance sheet date.

Deferred tax assets concerning non-deductible temporary differences and tax loss carry-forwards are only reported to the extent

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Note 2 continued

that it will be possible for these to be used. The value of deferred tax assets is reduced when it is no longer considered likely that they can be used.

Contingent liabilities

A contingent liability is reported when there is a possible obligation that arises from events and whose existence is only confirmed by one or more doubtful future events or when there is an obligation that is not reported as a liability or provision because it is not likely that an outflow of resources will be required.

Note 3 Transition to International Financial Reporting Standards (IFRS)

As stated in Note 2 – Accounting principles of the consolidated accounts, as of 2005 Vattenfall's consolidated accounts are prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) as well as the statements of interpretation issued by the International Financial Reporting Interpretations Committee (IFRIC) as approved by the European Commission for application within the EU. Also included are the International Accounting Standards (IAS) issued by IASB's predecessor the International Accounting Standards Committee (IASC) and the statements of interpretation issued by IFRIC's predecessor the Standing Interpretations Committee (SIC).

The Swedish Financial Accounting Standards Council's recommendations, which were applied by the Vattenfall Group until the end of 2004, are largely based on IFRS, which is why the consolidated accounts have, to a large extent, already been adapted to the new rules.

As Vattenfall presents comparative consolidated information for one year in its financial reports, the date for the transition to IFRS was set to 1 January 2004, with the exception of financial instruments defined in accordance with IAS 39 – Financial Instruments.

IAS 39 is applied as of 2005 (see also Note 4 of the consolidated accounts, Changes in accounting principles from 1 January 2005) and, in accordance with the transition rules, the comparative figures for 2004 have not been restated.

Effects of the transition to IFRS

The rules for how the introduction and restatement have been carried out are stipulated in IFRS 1 – First-time Adoption of International Financial Reporting Standards. The figures for the comparative year 2004 have been restated.

The most important changes in the accounting principles of the Vattenfall Group are described below in conjunction with the presentation of the effects on equity as of 1 January 2004 and 31 December 2004 respectively, as well as on profit for the year 2004.

The changes described in the tables below agree with the information presented in Vattenfall's Annual Report 2004 (Note 3 of the consolidated accounts, Transition to International Financial Reporting Standards (IFRS)) with some exceptions. Some reclassifications have been made under non-current assets and the net reporting of exchange rate differences has entailed altered values for financial income and financial expenses. Vattenfall's nine-month interim report for 2005 included a renewed review of the transition to IFRS as regards obligations for decommissioning etc. within Swedish nuclear power operations that showed that the provisions made should have been higher. For the full year 2004, the provisions adjustment amounts to SEK 684 million, which implies a corresponding increase in financial expenses and a reduction in the profit for the year of SEK 491 million. Operating profit (EBIT) and cash flow are not affected by this adjustment.

In accordance with IFRS 1, the accounts have been prepared according to the IFRS standards that applied as of 31 December 2005. Moreover, these standards shall have been approved by the EU. As a starting point, it is assumed in IFRS 1 that all standards will be applied retroactively, but there are exceptions to this rule. The extent to which the Vattenfall Group has utilised these exceptions is documented in the Comments below.

Restated equity and net profit for the Group

Reconciliation of balance sheet and equity as of 1 January 2004 (date for transition to IFRS)

	Swedish GAAP ¹	A	B	Effects upon transition to IFRS			F	G	Total H adjustment	IFRS	
				C	D	E					
Assets											
Non-current assets											
Intangible assets	5,050	–	–	–	–	547	–	–	–	547	5,597
Property, plant and equipment	182,448	–	–	854	3,188	–	–	–	–	4,042	186,490
Other non-current assets	29,260	–	–	22,949	176	–	–	–	–	23,125	52,385
Total non-current assets	216,758	0	0	23,803	3,364	547	0	0	0	27,714	244,472
Current assets											
Inventories	7,283	–	–	86	–	–	–	–	–	86	7,369
Current receivables etc.	26,832	–	–	–	–	–	–	–	–	0	26,832
Short-term investments	11,974	–	–	–	–	–	–	–	–4,628	–4,628	7,346
Cash and cash equivalents	2,673	–	–	–	–	–	–	–	4,628	4,628	7,301
Total current assets	48,762	0	0	86	0	0	0	0	0	86	48,848
Total assets	265,520	0	0	23,889	3,364	547	0	0	0	27,800	293,320
Minority interests, provisions and liabilities											
Minority interests	9,379	–	–	–	–	–	–9,379	–	–	–9,379	0
Provisions	93,109	–10,123	–	21,539	1,652	218	–106,395	–	–	–93,109	0
Non-current liabilities	72,081	–	–	–	–	–	–	–	–	101,966	174,047
Current liabilities	39,115	–	–	–	–	–	–	–	4,429	–	43,544
Total minority interests, provisions and liabilities	213,684	–10,123	0	21,539	1,652	218	–9,379	0	0	3,907	217,591
Equity	51,836	10,123	0	2,350	1,712	329	9,379	0	0	23,893	75,729
Total liabilities and equity	265,520	0	0	23,889	3,364	547	0	0	0	27,800	293,320

1) As reported on 31 December 2003, but adjusted for the effect of the new accounting principle as regards RR29 (IAS 19) – Employee Benefits. Some reclassifications have been made under non-current assets.

Reconciliation of balance sheet and equity as of 31 December 2004

	Swedish GAAP ¹	A	B	Effects upon transition to IFRS					Total H adjustment	IFRS	
Assets											
Non-current assets											
Intangible assets	4,587	-	134	-	-	464	-	-	-	598	5,185
Property, plant and equipment	178,227	-	-	553	2,958	-	-	-	-	3,511	181,738
Other non-current assets	27,961	-	-	23,952	76	-	-	-	-	24,028	51,989
Total non-current assets	210,775	0	134	24,505	3,034	464	0	0	0	28,137	238,912
Current assets											
Inventories	7,470	-	-	107	-	-	-	-	-	107	7,577
Current receivables etc.	25,054	-	-	46	-	-	-	-	-	46	25,100
Short-term investments	11,063	-	-	-	-	-	-	-	-3,363	-3,363	7,700
Cash and cash equivalents	2,553	-	-	-	-	-	-	-	3,363	3,363	5,916
Total current assets	46,140	0	0	153	0	0	0	0	0	153	46,293
Total assets	256,915	0	134	24,658	3,034	464	0	0	0	28,290	285,205
Minority interests, provisions and liabilities											
Minority interests	9,188	-	-	-	-	-	-9,188	-	-	-9,188	0
Provisions	86,901	-6,928	-	22,112	1,319	183	-103,587	-	-	-86,901	0
Non-current liabilities	66,254	-	-	-	-	-	-	98,717	-	98,717	164,971
Current liabilities	32,256	-	-	-	-	-	-	4,870	-	4,870	37,126
Total minority interests, provisions and liabilities	194,599	-6,928	0	22,112	1,319	183	-9,188	0	0	7,498	202,097
Equity	62,316	6,928	134	2,546	1,715	281	9,188	0	0	20,792	83,108
Total liabilities and equity	256,915	0	134	24,658	3,034	464	0	0	0	28,290	285,205

1) As reported on 31 December 2004 but adjusted for certain reclassifications under non-current assets.

Reconciliation of income statement for 2004.

	Swedish GAAP ¹	A	B	Effects upon transition to IFRS					Total H adjustment	IFRS	
Net sales	113,366	-	-	-	-	-	-	-	0	113,366	
Cost of products sold	-81,992	-3,034	122	52	65	-	-	939	-	-1,856	-83,848
Gross profit	31,374	-3,034	122	52	65	0	0	939	0	-1,856	29,518
Selling expenses, research and development costs and administrative expenses	-12,139	-	-	-	-	-77	-	-356	-	-433	-12,572
Other operating income and expenses, net	1,126	-	-	-	-	-	-	-	-	0	1,126
Participations in the results of associated companies	-754	-	-	-206	-	-	-	-	-	-206	-960
Operating profit (EBIT)	19,607	-3,034	122	-154	65	-77	0	583	0	-2,495	17,112
Financial income	1,225	-	-	1,253	-	-	-	491	-	1,744	2,969
Financial expenses	-3,473	-	-	-897	-23	-	-	-1,074	-	-1,994	-5,467
Profit before tax and minority interests	17,359	-3,034	122	202	42	-77	0	0	0	-2,745	14,614
Income tax expense	-5,011	-	-	-5	-23	29	-	-	-	1	-5,010
Minority interests	-572	-	-	-	-	-	572	-	-	572	0
Profit for the year	11,776	-3,034	122	197	19	-48	572	0	0	-2,172	9,604

1) As reported for 2004 but adjusted for net reporting of exchange rate differences under financial income and expenses.

Comments

IAS 19

As of 1 January 2004 the Vattenfall Group applies RR 29 (IAS 19) – Employee Benefits. All actuarial gains and losses as of 1 January 2004, the date of the transition to IFRS, are included in the net obligation and are therefore included in the balance sheet in accordance with Swedish GAAP as of 1 January 2004 above.

IFRS 3

According to IFRS 3 – Business Combinations, acquired assets and liabilities shall be valued at fair value. If the net value of the acquired assets and liabilities exceeds the purchase price, the difference shall be reported as income (previously designated negative goodwill). Goodwill shall not be amortised. Impairment of assets shall be assessed each year.

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Note 3 continued

A. Negative goodwill

Negative goodwill on the balance sheet, in accordance with Swedish GAAP, is entered against equity and the dissolution made during 2004 is reversed.

B. Amortisation of goodwill

Goodwill amortised during 2004 in accordance with Swedish GAAP is reversed.

IAS 16, IFRIC 1 and IFRIC 5

According to IAS 16, estimated future expenses for decommissioning and dismantling property, plant and equipment shall be included in cost. The present value of the future costs is reported as a provision. For first-time adopters, special exceptions to the rules apply in accordance with IFRIC 1 for the calculation of the capitalised amount. According to IFRIC 5 (which was applied in advance), funds for future decommissioning and dismantling costs shall, in certain cases, be capitalised (reported as an asset) in the balance sheet.

C. Obligations for decommissioning etc. in nuclear power operations

Vattenfall's nuclear power producers 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 calculations for Swedish nuclear power plants are based on a useful life of 40 years.

The present value calculated in accordance with IAS 37 – Provisions, Contingent Liabilities and Contingent Assets, when the plant was commissioned is included, in accordance with IAS 16 – Property, Plant and Equipment, in the cost of the plant and depreciated over the useful life. According to IAS 2 – Inventories, the part of the provision that is a variable sum for the safeguarding of spent fuel is included in inventories and carried as an expense in the income statement as the fuel is used.

In most cases, the provisions concern obligations far in the future, which is why they are reported at discounted values. The annual change in the provision, which reflects the fact that the due date is approaching (discounting effects), is reported as a financial expense. Changes in existing provisions are calculated in accordance with IFRIC 1 – Changes in Existing Decommissioning, Restoration and Similar Liabilities.

In Sweden, payments are made to the Swedish Nuclear Waste Fund for the purpose of covering the future costs for the nuclear power producers' obligations. The fee paid to the Swedish Nuclear Waste Fund is determined by the Swedish government. Vattenfall's share in the Swedish Nuclear Waste Fund is of such a nature that it shall be reported as an asset in the balance sheet. Returns on this share of the fund are reported as financial income. According to Swedish GAAP, it has been generally accepted practice to neither report the value of the fund nor the value of the obligation in the balance sheet. Payments to the fund have instead been reported as expenses.

D. Obligations for restoration etc. in mining operations

Vattenfall's mining operations in Germany entail a right to mine lignite. This mining right incorporates a legal obligation to restore and re-cultivate the land used for operations.

The present value calculated in accordance with IAS 37 – Provisions, Contingent Liabilities and Contingent Assets, when the plant was commissioned is included, in accordance with IAS 16 – Property, Plant and Equipment, in the cost and depreciated over the useful life. In accordance with Swedish GAAP, no part of this provision has been included in the value of the asset.

The annual change in the provision, which reflects the fact that the due date is approaching (discounting effects), is reported as a financial expense. Changes in existing provisions are calculated in accordance with IFRIC 1.

IAS 38

According to IAS 38 – Intangible Assets, development costs shall be reported as intangible assets (capitalised) when certain criteria are fulfilled. Capitalised assets are subject to amortisation. According to IFRS 1, all development costs arising after the introduction of IAS 38 shall be capitalised if the requirements for capitalisation are fulfilled. This is the case irrespective of whether the costs have been carried as an expense in accordance with earlier accounting principles. Swedish GAAP did not permit retroactive application upon the adoption of the equivalent recommendation.

E. Capitalisation of development costs

Development costs that fulfil the established criteria are capitalised as an asset in the balance sheet and burden the income statement with amortisation.

IAS 27

IAS 27 – Consolidated and Separate Financial Statements requires, among other things, that minority interests in profit for the year shall not reduce consolidated net profit and that minority interests in equity comprise a part of the reported consolidated equity. This is a change from Swedish GAAP, according to which minority interests are not included in net profit for the year or equity.

F. Minority interests

Minority interests in net profit for the year no longer comprise a deductible item in the income statement. Minority interests in equity are reported under equity in accordance with IFRS.

IAS 1

IAS 1 – Presentation of Financial Statements, specifies that liabilities shall be classified as current or non-current. Provisions previously reported in accordance with Swedish GAAP as a separate item alongside current liabilities and non-current liabilities are now reported as part of current and non-current liabilities respectively.

According to IAS 37, when, as a consequence of the due date approaching, one increases the reported amount over time in present value computation, the resulting effect is reported as a financial item. (Equivalent effects on provisions for pensions (IAS 19) will continue to be reported as an operating expense.)

G. Reclassification of provisions and provision-related interest

Provisions are reclassified in the balance sheet and discounting effects related to provisions are reclassified in the income statement.

IAS 7

According to IAS 7 – Cash Flow Statements, cash and cash equivalents shall only include cash and bank balances and similar assets and holdings in investments with a maturity of three months or less. According to Swedish practice, a broader interpretation has applied wherein even investments with maturities in excess of three months have been included.

H. Investments with a maturity of three months or less are correspondingly reclassified in the balance sheet between cash and cash equivalents and short-term investments respectively.

Exception rules

The transition to IFRS has been administered as prescribed by IFRS 1. In principle, the accounting principles shall be applied retroactively in order to provide opening balances in accordance with

IFRS. The following exceptions from retroactive application are permitted and have been applied by Vattenfall:

- The possibility to apply IFRS 3 – Business Combinations, prospectively as of the transition date, that is, 1 January 2004.
- The possibility to set translation differences to zero on the transition date according to IAS 21 – The Effects of Changes in Foreign Exchange Rates.
- The possibility not to restate financial information for 2004 in accordance with the requirements found in IAS 39 – Financial Instruments: Recognition and Measurement, the standard approved by the EU.
- The possibility to apply the exception in IFRIC 1 concerning the simplified method for changes in existing provisions for decommissioning and restoration.

Note 4 Changes in accounting principles from 1 January 2005

Reporting of financial instruments according to IAS 39 – Financial Instruments: Recognition & Measurement IAS 39, chiefly as regards the reporting of derivatives, has affected the balance brought forward as of 1 January 2005 as shown in the table below. The profit for 2005 has not been affected by this adjustment of the value of the balance brought forward as all changes in value have been entered directly against equity in accordance with the transition rules for first-time adopters of IFRS.

	IFRS 31 Dec. 2004 (see Note 3 above)	Effect of transition to IAS 39	IFRS 1 Jan. 2005
Assets			
Non-current assets			
Intangible assets	5,185	–	5,185
Property, plant and equipment	181,738	–	181,738
Other non-current assets	51,989	639	52,628
Total non-current assets	238,912	639	239,551
Current assets			
Inventories	7,577	–	7,577
Current receivables etc.	25,100	6,294	31,394
Short-term investments	7,700	65	7,765
Cash and cash equivalents	5,916	–	5,916
Total current assets	46,293	6,359	52,652
Total assets	285,205	6,998	292,203
Equity and liabilities			
Equity	83,108	–440	82,668
Non-current liabilities	164,971	962	165,933
Current liabilities	37,126	6,476	43,602
Total liabilities	202,097	7,438	209,535
Total liabilities and equity	285,205	6,998	292,203

Note 5 Acquired and divested operations

Larger companies that have been subject to acquisition or divestment are summarised below.

	Month	Company	Change, %	New ownership	Transfer amount, SEK millions	Comments
Acquisitions						
Nordic Countries	February	Elsam A/S, Denmark	35.3	35.3	10,325	Reported as an associated company for 2005
	April	Östersjöns Vindkraftpark AB, Sweden	100	100	5	
	May	Sweden Offshore Wind AB, Sweden	100	100	92	
	December	Harrsele Linjeaktibolag, Sweden	100	100	56	
		Metrima AB, Sweden	50	50	6	
Germany	2005	Vattenfall Europe AG	approx. 3	approx. 97	1,166	Market purchase
Divestments						
Nordic Countries	March	Abonnera i Sverige AB, Sweden	–100	–	5	
	November	Home Solutions AB, Sweden	–50	–	6	
	December	Leksand-Rättvik Energi AB, Sweden	–8.2	–	20	
		Vattenfall Tuggen AB, Sweden	–6.8	93.2	75	
Germany	July	IPH GmbH	–100	–	18	
	December	Solara AG	–21	–	73	
Poland	December	Coaltran Ltd	–75	–	107	

Note 6 Exchange rates

For the Vattenfall Group, key exchange rates applied in the accounts:

Country	Currency	Average rate		Balance sheet date rate	
		2005	2004	31 Dec 2005	31 Dec 2004
Euro	EUR	9.2812	9.1193	9.4300	9.0070
Denmark	DKK	1.2456	1.2260	1.2640	1.2115
Norway	NOK	1.1559	1.0887	1.1760	1.0880
Poland	PLN	2.3062	2.0192	2.4400	2.2100
USA	USD	7.4455	7.3314	7.9530	6.6130

Note 7 Net sales

	2005	2004
Sales including indirect taxes	134,691	119,740
Indirect taxes	–5,533	–6,374
Net sales	129,158	113,366

Note 8 Information on segments

The Group's activities are mainly conducted within three geographic areas. These primary segments are the Nordic Countries, Germany and Poland. There is also a segment termed Other (electricity trading, financial activities, research activities, service companies and Group functions). The Nordic Countries segment mainly covers operations in the Nordic countries, but also includes activities in the Baltic States and the Netherlands. The primary segments consist of areas based on the locations of assets.

The Group's activities are also divided into business segments (secondary segments), namely Electricity Generation, Electricity Trading (sales and trading), Electricity Networks (electricity transmission and distribution) and Heat (generation, distribution and sale of heat). Other activities include Vattenfall's financial activities, research activities, service companies and Group functions. Deliveries of electricity between segments are made at market prices. In the case of services between segments, cost prices generally apply, although in certain cases market prices are applied.

Primary segments

2005	Nordic Countries	Germany	Poland	Other	Eliminations	Total
External net sales	40,712	70,304	8,790	9,352	-	129,158
Sales between segments	1,309	34,691	60	35,211	-71,271	0
Total	42,021	104,995	8,850	44,563	-71,271	129,158
Operating profit (EBIT)	16,845	10,221	842	-178	-	27,730
Operating profit (EBIT) excl items affecting comparability	13,755	10,359	808	-178	-	24,744
Assets	137,696	179,310	17,302	106,427	-110,314	330,421
Liabilities	110,672	118,332	11,540	111,689	-110,278	241,955
Investments	17,432	5,072	812	1,200	-19	24,497
Depreciation and amortisation	4,203	9,123	656	44	-	14,026
Impairment losses	599	113	74	-	-	786
Participations in the results of associated companies	240	455	-	-2	-	693
2004	Nordic Countries	Germany	Poland	Other	Eliminations	Total
External net sales	38,843	63,514	7,421	3,588	-	113,366
Sales between segments	1,119	29,431	6	31,775	-62,331	0
Total	39,962	92,945	7,427	35,363	-62,331	113,366
Operating profit (EBIT)	12,215	4,591	711	-392	-13	17,112
Operating profit (EBIT) excl items affecting comparability	12,246	7,208	691	-805	-13	19,327
Assets	134,381	163,468	15,698	105,600	-133,942	285,205
Liabilities	102,997	111,633	12,228	98,198	-122,959	202,097
Investments	5,310	5,327	2,082	17	-5	12,731
Depreciation and amortisation	4,384	9,673	568	44	-	14,669
Impairment losses	170	435	-	-	-	605
Participations in the results of associated companies	92	-1,031	-	-21	-	-960

Secondary segments

2005	Electricity Generation	Electricity Market	Electricity Networks	Heat	Other	Eliminations	Total
External net sales	14,470	62,786	36,207	14,101	1,594	-	129,158
Sales between segments	42,944	10,476	14,606	6,824	5,684	-80,534	0
Total	57,414	73,262	50,813	20,925	7,278	-80,534	129,158
Operating profit (EBIT)	19,651	1,282	5,293	3,495	-1,991	-	27,730
Operating profit (EBIT) excl items affecting comparability	16,642	1,281	5,378	3,541	-2,098	-	24,744
Assets	201,400	32,899	80,448	47,980	124,248	-156,554	330,421
Investments	5,818	269	4,776	2,605	13,178	-2,149	24,497
2004	Electricity Generation	Electricity Market	Electricity Networks	Heat	Other	Eliminations	Total
External net sales	14,597	53,443	30,846	12,647	1,833	-	113,366
Sales between segments	36,531	8,282	13,915	5,673	4,429	-68,830	0
Total	51,128	61,725	44,761	18,320	6,262	-68,830	113,366
Operating profit (EBIT)	12,417	-839	6,129	2,622	-3,205	-12	17,112
Operating profit (EBIT) excl items affecting comparability	13,106	-322	6,365	3,023	-2,833	-12	19,327
Assets	201,075	24,301	81,392	43,109	121,413	-186,085	285,205
Investments	12,804	180	3,564	2,295	3,761	-9,873	12,731

Note 9 Cost of products sold

Direct costs include production taxes and duties of SEK 4,198 million (4,283) and property taxes of SEK 597 million (1,234). The costs also include interest components relating to annual pension costs, net after deductions for expected returns on the investment assets, of SEK 498 million (632).

Note 10 Other operating income

Other operating income comprises capital gains from the sale of non-current assets, operationally derived exchange rate gains, rental income and insurance compensation.

For 2005 this item also includes the compensation for future production losses amounting to SEK 4,100 million which Vattenfall receives for the closing of the Barsebäck 2. The agreement on compensation has been approved by the Swedish government, the Board of E.ON Sverige AB and the Board of Vattenfall AB. The approval of Malmö district court is expected in spring 2006.

Note 11 Selling expenses, administrative expenses, research & development costs

The costs include interest components relating to annual pension costs, net after deductions for expected returns on the investment assets, of SEK 295 million (198).

Note 12 Other operating expenses

Other operating expenses primarily comprises capital losses from the sale of non-current assets, operationally derived exchange rate losses and closedown and restructuring expenses.

Note 13 Depreciation and amortisation

Depreciation of property, plant and equipment and of investment property and amortisation of intangible assets in the income statement break down as follows:

	2005	2004
Cost of products sold	13,496	14,264
Investment property ¹	19	30
Selling expenses	167	120
Administrative expenses	343	254
Research and development costs	1	1
Total	14,026	14,669

1) Reported in the income statement under Other operating expenses.

Note 14 Impairment losses

Impairment losses and reversed impairment losses of intangible assets, property, plant and equipment and investment property in the income statement break down as follows:

	2005	2004
Impairment losses of cost of products sold	992	354
Reversed impairment losses of cost of products sold	-198	-
Impairment losses of investment property ¹	26	251
Reversed impairment losses of investment property ¹	-2	-
Reversed impairment losses of selling expenses	-43	-
Impairment losses of administrative expenses	11	-
Total	786	605

1) Reported in the income statement under Other operating expenses.

Due to the closing of Barsebäck, property, plant and equipment in Barsebäck Kraft AB have been impaired by SEK 599 million.

The goodwill impairment loss of SEK 180 million, included in impairment losses of the cost of products sold in the table above, is attributable to the German subsidiary Elbe Investitions- und Verwaltungsgesellschaft mBH.

After a decision to resume operations at the Reichwalde lignite mine in Germany, the impairment loss was reversed by SEK 119 million. In addition, the reassessment of a briquette factory in Germany has led to a reversal of SEK 109 million.

Note 15 Operating costs according to type

	2005	2004
Personnel costs	18,664	17,086
Depreciation and amortisation	14,026	14,669
Impairment losses	786	605
Other operating costs incl input commodities	74,042	65,022
Total	107,518	97,382

Note 16 Financial income

	2005	2004
Dividends	66	162
Interest income attributable to investments etc.	980	1 030
Returns from the Swedish Nuclear Waste Fund	2,089	1,253
Discounting effects attributable to provisions	-	491
Net change in value in the reassessment of derivatives	545	-
Net change in value in the reassessment of other financial assets	117	28
Capital gains from the divestments of shares and participations	13	5
Total	3,810	2,969

Note 17 Financial expenses

	2005	2004
Interest expenses attributable to loans etc.	2,967	3,431
Discounting effects attributable to provisions	2,060	1,994
Exchange rate differences, net	171	17
Impairment losses of shares and participations	17	17
Capital losses from the divestments of shares and participations	6	8
Total	5,221	5,467

See also Notes 9 and 11 of the consolidated accounts concerning interest components attributable to pension provisions.

Note 18 Taxes

Profit before income tax expense for the year amounted to:

	2005	2004
Sweden, Group companies	15,298	9,475
Sweden, associated companies	93	71
Other countries, Group companies	10,328	5,893
Other countries, associated companies	600	-825
Total	26,319	14,614

The reported income tax expense breaks down as follows:

	2005	2004
Current tax		
Sweden	2,666	2,453
Other countries	3,654	2,259
Deferred tax		
Sweden	819	303
Other countries	-1,338	-5
Total	5,801	5,010

The income tax expense for the year attributable to previous years amounts to SEK -509 million (-224).

The difference between the nominal Swedish tax rate and the effective tax rate is explained in the following manner:

Per cent	2005	2004
Swedish income tax rate	28.0	28.0
Difference in tax rate in foreign operations	3.3	4.2
Tax adjustment for previous periods	-1.9	-1.3
Amended tax rates	0.7	-
Non-deductible expenses and non-taxable income, net	-8.5	2.9
Impairment losses of goodwill	0.3	0.1
Other	0.1	0.4
Effective tax rate¹	22.0	34.3
Tax rate, current tax ²	24.0	27.1

1) Tax expense according to the consolidated income statement in relation to profit before tax.

2) Tax expense according to the consolidated income statement excluding reported deferred tax in relation to profit before tax.

Accumulated tax loss carry-forwards break down as follows:

	2005	2004
Sweden	19	33
Other countries	2,205	3,213
Total	2,224	3,246

The decrease in the reported amount is explained by the tax loss carry-forwards utilised in 2005.

The tax loss carry-forwards fall due as follows:

	2005
2006	9
2007	-
2008	-
2009	20
2010	97
No time limit	2,098
Total	2,224

Deferred tax assets and deferred tax liabilities are attributable to balance sheet items as follows:

Deferred tax assets	2005	2004
Non-current assets	3,016	5,035
Current assets	530	818
Equity	5,704	-
Non-current liabilities	5,274	2,626
Current liabilities	-171	59
Tax loss carry-forwards	216	234
Total	14,569	8,772

Deferred tax liabilities	2005	2004
Non-current assets	34,976	38,875
Current receivables	52	-144
Equity	141	-
Non-current liabilities	4,664	2,905
Current liabilities	2,537	10
Total	42,370	41,646

Deferred tax assets (changes in 2005)

Balance brought forward	8,772
Transition effect on adoption of new accounting principles (IAS 39)	639
Acquired companies	7
Additions/dissolutions for the period, net	4,951
Divested companies	-3
Translation differences	203
Balance carried forward	14,569

Deferred tax liabilities (changes in 2005)

Balance brought forward	41,646
Transition effect on adoption of new accounting principles (IAS 39)	383
Acquired companies	102
Additions/dissolutions for the period, net	-939
Divested companies	-3
Translation differences	1,181
Balance carried forward	42,370

Note 19 Minority interests

	2005	2004
Minority interests in profit before tax	1,422	959
Minority interests in income tax expense	-139	-299
Total	1,283	660

Note 20 Intangible assets

	Capitalised development costs		Goodwill		Concessions and similar rights with finite useful lives		Renting rights, mining rights and similar rights with finite useful lives		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Cost										
Cost brought forward	814	529	243	573	2,931	5,569	4,212	3,128	8,200	9,799
Acquired companies	-	-	180	40	135	310	-	-	315	350
Investments	426	282	-	-	159	144	17	9	602	435
Divestments/Disposals	-	-	-	-	-43	-179	-4	-47	-47	-226
Reclassifications	31	9	-	-398	-22	-2,899	38	1,161	47	-2,127
Divested companies	-	-	-	-	-3	-17	-	-	-3	-17
Translation differences	36	-6	28	28	93	3	165	-39	322	-14
Accumulated cost carried forward	1,307	814	451	243	3,250	2,931	4,428	4,212	9,436	8,200
Accumulated amortisation according to plan										
Amortisation brought forward	-274	-122	-	-	-1,885	-2,192	-892	-1,692	-3,051	-4,006
Acquired companies	-	-	-	-	-	-1	-	-	0	-1
Amortisation for the year	-197	-155	-	-	-238	-255	-227	-243	-662	-653
Divestments/Disposals	-	-	-	-	40	171	-	33	40	204
Reclassifications	3	-	-	-	15	372	-17	1,003	1	1,375
Divested companies	-	-	-	-	3	17	-	-	3	17
Translation differences	-16	3	-	-	-60	3	-38	7	-114	13
Accumulated amortisation carried forward	-484	-274	0	0	-2,125	-1,885	-1,174	-892	-3,783	-3,051
Impairment losses										
Impairment losses brought forward	-	-	-	-	-17	-39	-317	-300	-334	-339
Impairment losses for the year	-	-	-180	-211	-	-2	-205	-	-385	-213
Divestments/Disposals	-	-	-	-	-	-	-	7	0	7
Reclassifications	-	-	-	206	-	24	-	-24	0	206
Divested companies	-	-	-	-	-1	-	-	-	-1	0
Translation differences	-	-	-3	5	-1	-	-3	-	-7	5
Accumulated impairment losses carried forward	0	0	-183	0	-19	-17	-525	-317	-727	-334
Residual value according to plan carried forward	823	540	268	243	1,106	1,029	2,729	3,003	4,926	4,815
Advance payment to suppliers									341	370
Total									5,267	5,185

Note 21 Property, plant and equipment

	Land and buildings ¹		Plants and other technical installations		Equipment, tools, and fixtures and fittings		Construction in progress ²		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Cost										
Cost brought forward ³	65,378	68,104	333,986	325,792	8,784	9,619	7,081	6,495	415,229	410,010
Acquired companies	28	56	185	1,714	19	7	-	128	232	1,905
Investments ⁴	431	384	2,476	2,656	530	413	8,727	6,399	12,164	9,852
Capitalised/Reversed future expenses for decommissioning, restoration etc	1,298	-152	1,596	-23	-	-	-	-	2,894	-175
Transfer from construction in progress	1,088	370	7,133	5,319	67	90	-8,288	-5,779	0	0
Divestments/Disposals	-1,918	-624	-3,857	-2,047	-683	-289	-156	-12	-6,614	-2,972
Reclassifications to investment property	-	-2,499	-	-	-	-	-	-	0	-2,499
Other reclassifications	46	-	80	1,139	11	-927	-124	-144	13	68
Divested companies	-119	-315	-140	-215	-28	-83	-1	-1	-288	-614
Translation differences	2,074	54	12,501	-349	319	-46	127	-5	15,021	-346
Accumulated cost carried forward	68,306	65,378	353,960	333,986	9,019	8,784	7,366	7,081	438,651	415,229
Accumulated depreciation according to plan										
Depreciation brought forward	-30,378	-29,825	-193,758	-182,385	-7,274	-7,857	-	-	-231,410	-220,067
Acquired companies	-6	-	-26	-6	-15	-	-	-	-47	-6
Depreciation for the year	-1,638	-1,857	-11,135	-11,698	-571	-431	-	-	-13,344	-13,986
Divestments/Disposals	1,674	602	3,558	1,410	662	263	-	-	5,894	2,275
Reclassifications to investment property	-	540	-	-	-	-	-	-	0	540
Other reclassifications	-20	-	30	-1,346	-18	665	-	-	-8	-681
Divested companies	29	197	95	141	7	41	-	-	131	379
Translation differences	-999	-35	-7,110	126	-263	45	-	-	-8,372	136
Accumulated depreciation carried forward	-31,338	-30,378	-208,346	-193,758	-7,472	-7,274	0	0	-247,156	-231,410
Impairment losses										
Impairment losses brought forward	-877	-1,271	-1,604	-2,502	-51	-51	-9	-2	-2,541	-3,826
Acquired companies	-10	-	-37	-569	-	-	-	-1	-47	-570
Impairment losses/Reversed impairment losses	-21	-138	-348	-	-8	-	-	-3	-377	-141
Divestments/Disposals	116	4	28	91	-	-	-	-	144	95
Reclassifications to investment property	-	679	-	-	-	-	-	-	0	679
Other reclassifications	-106	-164	5	1,363	-	-	-	-3	-101	1,196
Translation differences	-45	13	-74	13	-2	-	-1	-	-122	26
Accumulated impairment losses carried forward	-943	-877	-2,030	-1,604	-61	-51	-10	-9	-3,044	-2,541
Residual value according to plan carried forward	36,025	34,123	143,584	138,624	1,486	1,459	7,356	7,072	188,451	181,278
Advance payment to suppliers									565	460
Total									189,016	181,738

1) Cost for land and buildings includes cost of land and water rights amounting to SEK 14,247 million (13,904), which are not subject to depreciation.

2) Interest during the construction period has been reported as an asset in the amount of SEK 7 million (69) for the year. Average fixed rate term for 2005 is 3.75 per cent.

3) Government grants received, balance brought forward, amount to SEK 4,409 million (4,378). Accumulated interest reported as an asset totalling SEK 573 million (566) is included in cost of buildings.

4) Government grants received during the year amount to SEK 66 million (146).

Tax assessment values (for Swedish real estate)

	2005	2004
Buildings	102,713	71,093
Land	29,821	26,140
Total	132,534	97,233

Distribution lines and transformer stations are not subject to tax assessment values.

Note 22 Investment property

	Land and buildings		Land and buildings	
	2005	2004	2005	2004
Cost				
Cost brought forward	2,499	2,614		
Investments	3	9		
Divestments/Disposals	-59	-93		
Reclassifications	-53	-		
Translation differences	115	-31		
Accumulated cost carried forward	2,505	2,499		
Accumulated depreciation according to plan				
Depreciation brought forward	-540	-558		
Depreciation for the year	-19	-30		
Divestments/Disposals	17	41		
Reclassifications	3	-		
Translation differences	-25	7		
Accumulated depreciation carried forward	-564	-540		
Impairment losses				
Impairment losses brought forward			-679	-442
Impairment losses/ Reversed impairment losses for the year			-24	-251
Divestments/Disposals			24	6
Reclassifications			26	-
Translation differences			-32	8
Accumulated impairment losses carried forward			-685	-679
Residual value according to plan carried forward			1,256	1,280
Estimated fair value			1,594	1,597

Investment property encompasses approximately 180 properties located in Berlin, Hamburg and former East Germany. The estimated fair value has been defined as the amount at which the concerned property could be exchanged between knowledgeable, willing partners in an arm's length transaction. The fair value calculations have mainly been made by Vattenfall's own assessors.

Rental income from external customers amounted to SEK 114 million in (109). Direct costs for the concerned properties amounted to SEK 248 million (292), of which SEK 82 million (146) is related to properties that did not generate rental income.

Note 23 Shares and participations owned by the parent company and Group companies

The list below encompasses the parent company's directly and indirectly held shares and participations.

Group companies	Corporate Identity Number	Registered office	Number of shares 2005	Participation in % 2005	Book value 2005
Nordic Countries					
Bergeforsens Kraft AB	556044-8887	Sundsvall	3,240	60	3
Energibolaget Botkyrka-Salem Försäljn. AB	556014-7406	Botkyrka	24,000	100	35
eXcert AB	556500-4974	Malmö	11,000	100	1
Forsaströms Kraft AB	556010-0819	Åtvidaberg	400,000	100	48
Forsmarks Kraftgrupp AB	556174-8525	Östhammar	198,000	66	198
Försäkrings AB Vattenfall Insurance	516401-8391	Stockholm	200,000	100	200
Gotlands Energi AB	556008-2157	Gotland	112,500	75	13
Kraftbyggarna Entreprenad AB	556333-2468	Luleå	38,000	100	46
Nordic Power Invest AB	556377-2861	Stockholm	218,000	100	131
Produktionsbalans PBA AB	556425-8134	Stockholm	4,800	100	5
Ringhals AB	556558-7036	Varberg	300,000	74	457
Svensk Kärnbränslehantering AB ¹	556175-2014	Stockholm	360	36	0
Sweden Offshore Wind AB	556622-5941	Stockholm	1,000	100	91
SwedPower AB	556383-5619	Stockholm	12,500	100	15
Säffle Årjäng Energi AB	556499-8689	Säffle	8,000	100	22
Vattenfall Bränsle AB	556440-2609	Stockholm	100	100	96
Vattenfall Danmark A/S	250526	Gentofte	8,200,000	100	8
Vattenfall Business Services Nordic AB	556439-0614	Stockholm	100	100	10
Vattenfall Fastigheter AB	556438-5952	Sundsvall	100	100	120
Vattenfall Inlandskraft AB	556528-2562	Stockholm	3,000	100	4
Vattenfall Oy	1071366-1	Helsinki	10,000	100	1,483
Vattenfall Power Management AB	556573-5940	Stockholm	6,570	100	6
Vattenfall Eldistribution AB	556417-0800	Stockholm	8,000	100	11
Vattenfall Service Nord AB	556242-2959	Luleå	10,000	100	1
Vattenfall Service Syd AB	556417-0859	Trollhättan	16,000	100	18
Vattenfall Treasury AB (publ)	556439-0606	Stockholm	500	100	6
Vattenfall Utveckling AB	556390-5891	Älvkarleby	14,000	100	17
Vattenfall Vätter El AB	556528-3180	Motala	100	100	291
Västerbergslagens Elnät AB	556565-6864	Ludvika	1,518	51	2
Västerbergslagens Energi AB	556565-6872	Ludvika	7,590	51	8
Västerbergslagens Kraft AB	556194-9784	Ludvika	89,726	58	19
Västerbergslagens Värme AB	556565-6856	Fagersta	5,566	51	6
Örestads Vindkraftspark AB	556550-1292	Malmö	219,919	100	125
Östersjöns Vindkraftspark AB	556644-2595	Malmö	1,000	100	5
Other companies					9

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Note 23 continued

Group companies	Corporate Identity Number	Registered office	Number of shares 2005	Participation in % 2005	Book value 2005
Germany					
Vattenfall Deutschland GmbH	(HRB) 62659	Hamburg	2	100	18,868
Vattenfall Europe AG ²	HRB 1955	Berlin	72,689,384	38	10,828
Poland					
Elektrocieplownie Warszawskie S.A.	38,440	Warsaw	18,366,042	75	3,239
Gornoslaski Zaklad Elektroenergetyczny S.A.	RHB 9861	Gliwice	935,341	75	5,268
Vattenfall Trading Services Sp.z.o.o	969-1406-317	Rejonowy	80,000	100	9
Other countries					
Vattenfall Estonia OÜ	10142764	Tallinn	100	100	6
Vattenfall Reinsurance S.A.	(B) 49528	Luxembourg	12,999	100	13
Other companies					1
Total					41 742

1) Group companies own a further 20 per cent through Forsmarks Kraftgrupp AB.

2) Vattenfall AB and other Group companies own a total of approx. 97 per cent (94) through Vattenfall Deutschland's holding.

Larger shareholdings held by Group companies

	Registered office	Participation in % 2005
Nordic Countries		
Barsebäck Kraft AB	Malmö	74
Pamilo Oy	Uimaharju	100
Vattenfall Indalsälven AB	Bispgården	74
Vattenfall Tuotantoverkko Oy	Helsinki	100
Vattenfall Verkko Oy	Helsinki	100
Germany		
Bewag AG & Co. KG	Berlin	97
Energie Südwest AG	Landau	51
Fernheizwerk Neukölln AG	Berlin	73
Fernheizwerk Märkisches Viertel GmbH	Berlin	97
Hamburgische Electricitäts-Werke AG	Hamburg	97
HEW Verteilungsnetz GmbH & Co KG	Hamburg	97
Kernkraftwerk Brunsbüttel GmbH & Co oHG	Hamburg	65
Koros GmbH & Co. KG	Cologne	95
MVR Müllverwertung Rugenberger Damm GmbH	Hamburg	55
Vattenfall Europe AG	Berlin	97
Vattenfall Europe Generation GmbH	Berlin	97
Vattenfall Europe Mining AG	Cottbus	97
Vattenfall Europe Nuclear Energy GmbH	Berlin	97
Vattenfall Europe Sales GmbH	Berlin	97
Vattenfall Europe Transmission GmbH	Berlin	97
Vattenfall Europe Waste to Energy GmbH	Hamburg	97
Vattenfall Trading Services GmbH	Hamburg	97
VEAG Kraftwerke Schwarze Pumpe GmbH	Vetschau	97
WEMAG AG	Schwerin	77
Poland		
Nieruchomosci EWSA Grupa Vattenfall	Warsaw	75

Note 24 Participations in associated companies

	2005	2004
Balance brought forward	12,286	13,796
Investments	10,325	40
New share issues and shareholders' contributions	18	2
Divestments	-2	-30
Reclassifications	-4	-12
Change in value	-38	-601
Impairment losses	-	-773
Translation differences	836	-136
Balance carried forward	23,421	12,286

The list below encompasses shares and participations owned directly or indirectly by the parent company and its subsidiaries.

	Corporate Identity Number	Registered office	Number of shares 2005	Participation in % 2005	Book value Group 2005	Book value Parent company 2005
Directly-owned associated companies						
Nordic Countries						
i/s Avedøreværket 2	(LEV) 221005	Gentofte		40	14	14
Bodens Energi AB	556200-9117	Boden	20	40	65	0
Elsam A/S	CVR 254 60715	Skaerbaek	7,059,298	35	10,755	10,325
Gulsele AB	556001-1800	Sollefteå	84,000	35	336	332
Luleå Energi AB	556139-8255	Luleå	54,000	30	207	3
PiteEnergi AB	556330-9227	Piteå	70,000	50	192	7
Plusenergi AB	556572-4696	Gothenburg	50,000	50	176	170
Preem Gas AB	556037-2970	Stockholm	750	30	7	7
SwePol Link AB	556530-9829	Stockholm	96,000	16	2	2
Other companies						
Indirectly-owned associated companies						
Germany						
ESAG Energieversorgung						
Sachsen Ost AG	HRB 965	Dresden	436,928	29	1,024	–
GASAG Berliner Gaswerke AG	HRB 44343	Berlin	8,100,000	32	3,253	–
Kernkraftwerk Krümmel GmbH	HRB 15033	Hamburg		50	4,174	–
Kernkraftwerk Stade GmbH	HRB 12163	Hamburg		33	932	–
Kernkraftwerk Brokdorf GmbH	HRB 17623	Hamburg		20	1,683	–
Städtische Werke Kassel AG	HRB 2150	Kassel	121,148	25	391	–
TVF GmbH	HRB 3506	Lübbenau		50	16	–
Other companies						
Other countries						
Compania Electrica de Sochagota	46782	Colombia			167	–
Total					23,421	10,860

Note 25 Other long-term securities holdings

	2005	2004		Book value Group 2005	Book value Parent company 2005
Balance brought forward	2,448	2,902			
Investments	8	5			
New share issues and shareholders' contributions	1	–			
Divestments	–61	–450			
Reclassifications	–51	13			
Reclassifications to subsidiaries ¹	–1,667	–			
Impairment losses	–13	–22			
Translation differences	82	–			
Balance carried forward	747	2,448			
Directly-owned securities holdings					
Nordic Countries					
Jämtkraft AB, Sweden	20 ¹		23	23	
Metrima AB, Sweden	50		6	6	
Other companies			5	5	
Other countries					
Eutilia, Netherlands	8		3	3	
Indirectly-owned securities holdings					
Germany					
AVG Abfall-Verwertungs- Gesellschaft mbH	20		25	–	
EHA Energie Handels GmbH & Co KG	50		13	–	
GNS Gesellschaft für Nuklearservice GmbH	6		23	–	
Stadtwerke Eilenburg GmbH	49		53	–	
Stadtwerke Parchim GmbH	15		28	–	
Stadtwerke Rostock AG	12		378	–	
Stadtwerke Wittenberg GmbH	23		26	–	
Other companies			105	–	
Other countries/companies					
Asikkalan Voima Oy, Finland	50		10	–	
Terki Oy, Finland	20		12	–	
Åtvidabergs Fjärrvärme AB, Sweden	50		10	–	
ELINI, Netherlands	22 ²		27	–	
Total			747	37	

1) Due to Vattenfall taking over the general partner function in the German company Koros GmbH & Co. KG.

1) Share of voting rights is 16 per cent.
2) Share of voting rights is 14 per cent.

Note 26 Share in the Swedish Nuclear Waste Fund

	2005	2004
Balance brought forward	19,447	18,567
Payments	528	308
Disbursements	-661	-681
Returns	2,089	1,253
Balance carried forward	21,403	19,447

According to the Swedish Nuclear Activities Act (1984:3), any organisation in Sweden with a permit to own or run a nuclear installation is obliged to demolish the plant in a safe manner, to manage spent fuel and other radioactive waste and to conduct necessary research and development. The permit holder shall also finance said management etc.

The Swedish Act on the Financing of Future Expenses of Spent Nuclear Fuel etc. (1992:1537, latest amendment 1995:1544) ensures said financing by requiring that the permit holder pays a fee based on generation. This fee is paid to the Swedish Nuclear Waste Fund, which manages the received funds. The fund disburses the owner of the reactor for expenses as the owner's obligations in accordance with Swedish Nuclear Activities Act (1984:3) are fulfilled. According to agreements between the Swedish state, Vattenfall AB and E.ON Sverige AB, fund assets for Ringhals AB shall be managed by Vattenfall AB and fund assets for Barsebäck Kraft AB by E.ON Kärnkraft Sverige AB.

On 31 December, the fair value of the Vattenfall Group's share of the Swedish Nuclear Waste Fund was SEK 23,889 million (22,271).

As stated in Note 36 of the consolidated accounts, provisions for future expenses for decommissioning etc. within Swedish nuclear power operations amount to SEK 18,149 million (16,515).

Contingent liabilities attributable to the Swedish Nuclear Waste Fund are described in Note 43 of the consolidated accounts.

Note 27 Long-term receivables

	Receivables from associated companies		Other receivables	
	2005	2004	2005	2004
Balance brought forward	1,860	1,961	5,896	5,176
Transition effect on adoption of new accounting principles	-	-	-	555
New receivables	2	15	185	227
Payments received	-52	-127	-3,962	-
Impairment losses	-	-	-5	-5
Divested companies	-3	-	-	-4
Exchange rate differences	62	-13	155	-61
Reclassifications	380	24	-233	8
Balance carried forward	2,249	1,860	2,036	5,896
Breakdown of receivables:	2005	2004	2005	2004
Long-term interest-bearing receivables	2,152	1,760	473	4,418
Long-term non-interest-bearing receivables	97	100	1,563	1,478
Total	2,249	1,860	2,036	5,896

Note 28 Inventories

	2005	2004
Emission allowances	5,371	-
Nuclear fuel	3,683	3,995
Oil	374	360
Coal etc.	1,258	1,320
Materials and spare parts	1,981	1,902
Total	12,667	7,577

Note 29 Trade and other receivables

	2005	2004
Accounts receivable	16,758	15,381
Receivables from associated companies	478	2,507
Derivatives with positive fair values	9,467	-
Other receivables	11,244	2,897
Total	37,947	20,785

Note 30 Prepaid expenses and accrued income

	2005	2004
Prepaid insurance premiums	37	35
Prepaid expenses, other	501	408
Prepaid expenses and accrued income, electricity	2,132	650
Accrued income, other	1,789	1,958
Total	4,459	3,051

Note 31 Short-term investments

	2005	2004
Interest-bearing investments	7,243	6,944
Shares	782	756
Total	8,025	7,700

Note 32 Cash and cash equivalents

	2005	2004
Cash and cash equivalents	4,850	2,553
Interest-bearing investments	1,199	3,363
Total	6,049	5,916

Note 33 Capital Securities

In June 2005, Vattenfall issued Capital Securities, which are reported as interest-bearing non-current liabilities. The tenor of the Capital Securities is perpetual and they are junior to all of Vattenfall's unsubordinated debt instruments. There is no redemption requirement although the intention is to repay the loan. The interest is fixed for the initial ten-year period, thereafter a floating rate is applied. The interest is conditional upon, among other things, Vattenfall's means of paying dividends to shareholders and the key ratio 'Interest Coverage Trigger Ratio' amounting to at least 2.5.

	2005	
Original amount	9,248	
Exchange rate differences	11	
Discount allocation	9	
Balance carried forward	9,268	
The Interest Coverage Trigger Ratio key ratio is calculated as follows:		
	2005	2004
Funds from operations (FFO)	31,386	24,302
Interest paid	2,230	3,693
FFO plus interest paid (a)	33,616	27,995
Interest expenses (b)	2,967	3,431
Interest Coverage Trigger Ratio (a/b)	11.33	8.16

Note 34 Other interest-bearing liabilities (non-current)

	2005	2004
Bond loans	38,808	38,062
Liabilities to credit institutions	7,300	7,896
Liabilities to minority owners	4,003	3,736
Liabilities to associated companies	9,052	13,635
Other liabilities	702	790
Total	59,865	64,119

Of the above liabilities, the following amounts are due after more than five years: Bond loans SEK 15,572 million (18,803), Liabilities to credit institutions SEK 3,579 million (3,892), Liabilities to minority owners SEK 3,827 million (3,324) and Other long-term borrowings SEK 138 million (138).

Borrowing programmes and credit facilities

	Maximum aggregated amount	Currency	Maturity	Used proportion, %	Reported external liability
Programmes					
Commercial Papers	15,000	SEK		–	–
Euro Commercial Paper	1,000	USD		57	–
Medium Term Note	10,000	SEK		20	2,015
Euro Medium Term Note	6,000	USD		71	39,800
Polish Commercial Paper	1,000	PLN		–	–
Committed credit facilities					
Revolving Credit Facility ¹	600	EUR	2009	–	–
364 Days Credit Facility ¹	1,260	EUR	2006	–	–
Bank overdraft facilities	212	SEK		–	–
Uncommitted credit facilities					
Bank overdraft facilities and other lines of credit	10,415	SEK		2	–
Total					41,815

1) Back-up facility for short-term borrowing

Benchmark bonds

Type	Currency	Amount	Coupon, %	Maturity
Euro Medium Term Note	EUR	500	6.125	2007
Euro Medium Term Note	EUR	650	6.0	2009
Euro Medium Term Note	EUR	500	6.0	2010
Euro Medium Term Note	EUR	500	5.0	2018
Euro Medium Term Note	EUR	500	5.375	2024

Note 35 Financial risks

Financial risks

The Group's financial risks are mainly managed by Vattenfall Treasury AB, which houses the Group's internal bank and finance function. These finance operations are intended to provide cost-effective management of the Group's financial risks.

The Group's funding, investments and currency trading are mainly carried out by Vattenfall Treasury AB and, to a lesser extent, by Vattenfall Europe AG. The Group's liquidity is centralised using so-called group cash pool systems. Speculative investments are made to a limited extent within fixed risk limits.

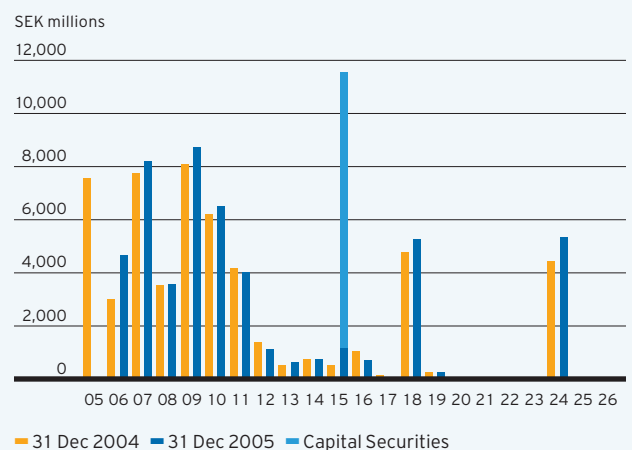
Financing risk

Financing risk is minimised through a debt portfolio with an even maturity profile and a long average remaining term. The maturity profile of Vattenfall's debt is shown in the diagram below. On 31 December, the average maturity was 6.0 years (6.1) excluding Capital Securities. The aim is for it to exceed 5 years.

To safeguard the availability of funds and maintain flexibility, the Group has several types of debt issuance programme. At present, there are two commercial paper programmes, two medium term note (MTN) programmes and one Polish bond programme. In addition, Vattenfall has approximately SEK 17.8 billion in committed credit facilities.

The Group's target for short-term liquidity is always to have no less than 10 per cent of the Group's sales and at least the equivalent of the next 90 days' maturities in the form of liquid assets or committed credit facilities. Vattenfall's credit rating for long-term and short-term borrowing respectively is A-/A-2 from Standard & Poor's and A2/P-1 from Moody's. In June, Moody's upgraded Vattenfall's rating from A3 to A2, the result of its new Government Related Issuer (GRI) methodology. Both institutes changed their outlook from stable to positive. Vattenfall's goal with regard to credit rating is to retain a rating in the Single A category.

Maturity profile in debt portfolio¹



1) Excluding loans from minority owners and associated companies.

Continuation on page 96

Note 35 continued

Interest rate risk

Interest rate risk in the Group's debt portfolio is measured as the duration, which at year-end was 2.5 years excluding Capital Securities. The duration is permitted to vary from a norm of 2.5 years by up to 12 months either way. Interest rate swaps, interest rate terms and options, for example, are used to adjust the duration in borrowing.

Remaining fixed rate term in loan portfolio

Excluding Capital Securities and loans from minority owners and associated companies. Nominal amount.

	SEK	EUR	Other	Total
<3 months	-5,387	-3,977	8	-9,356
3 months-1 year	1,169	3,020	-	4,189
1 year-5 years	31,111	23,282	-	54,393
>5 years	-160	-601	-	-761
Total	26,733	21,724	8	48,465
Average financing rate, %	4.8	3.8		4.4

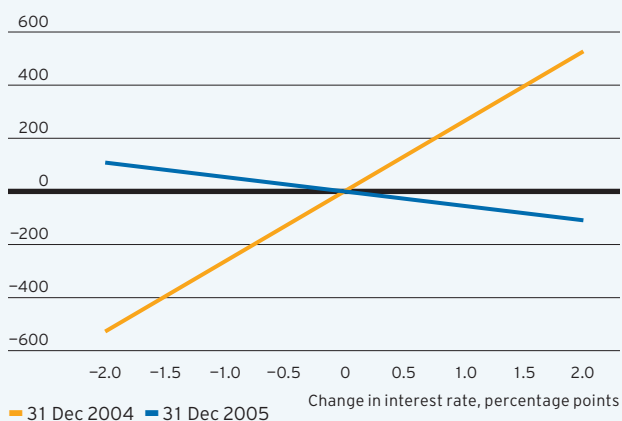
Remaining fixed rate term in loan portfolio

Excluding Capital Securities and loans from minority owners and associated companies. Nominal amount.

	Debt	Swaps	Total
<3 months	7,256	-16,612	-9,356
3 months-1 year	4,579	-390	4,189
1 year-5 years	23,204	31,189	54,393
>5 years	14,322	-15,083	-761
Total	49,361	-896	48,465

Interest rate sensitivity, excluding Capital Securities and loans from minority owners and associated companies.

SEK millions



The diagram shows how changes in interest rates affect the Group's interest expenses over a 12-month period based on the Group's present fixed rate structure.

Currency risk

Currency risk is the risk of negative effects on Vattenfall's earnings and balance sheet as a result of exchange rate fluctuations. Vattenfall is exposed to currency risk through exchange rate fluctuations attributable to future cash flows – so-called transaction exposure – and in the reassessment of net assets in non-Swedish subsidiaries, so-called translation exposure (or currency exposure).

The Group's goal in managing currency risk is to minimise foreign exchange losses while taking into account hedging costs and tax aspects. Currency exposure in borrowing is eliminated using interest currency swaps for the purpose of avoiding the effect of exchange rate differences on earnings.

Loan portfolio, breakdown per currency

Including loans from minority owners and associated companies but excl Capital Securities. Nominal amount.

Original currency	Debt	Swaps	Total
CZK	162	-162	0
EUR	52,097	-16,501	35,596
HKD	782	-782	0
JPY	4,895	-4,895	0
NOK	412	-412	0
PLN	8	0	8
SEK	7,347	23,884	31,231
USD	2,028	-2,028	0
Total	67,731	-896	66,835

The Group has limited transaction exposure, as the greater part of energy generation, distribution and sales is made in each company's local market. In Nordic operations, most transaction exposure is in NOK and EUR in conjunction with the hedging of electricity prices, primarily in Nord Pool. This currency exposure is hedged with forward exchange rate contracts. In the German subsidiaries, transaction exposure arises primarily in USD in conjunction with the purchase of fuel. Also this currency exposure is hedged with forward exchange rate contracts.

Consolidated operating revenues/expenses per currency, %

Currency	Revenues	Expenses
EUR	61	70
SEK	31	18
PLN	7	8
DKK	1	2
USD	-	2
Total	100	100

The amounts are calculated from a statistical compilation of external operating revenues/expenses. Changes in inventories and investments are not included in the compilation.

The Group's units shall hedge contracted transaction exposure when it exceeds the equivalent of SEK 10 million. Hedges shall be made through Vattenfall's treasury units in Sweden or Germany, where currency risks are managed within established risk limits for interest rates and currencies.

The Group's policy with regards to translation exposure is that equity shall be fully hedged with certain restrictions and with consideration for tax effects. A change in exchange rates of 5 per cent would affect consolidated equity by approximately SEK 1,570 million. Translation exposure is managed as described under Derivatives and Hedging in Note 2 – Accounting Principles of the consolidated accounts.

Translation exposure

Currency	Equity	Hedging after tax	Net exposure after tax
EUR	52,945	39,635	13,310
PLN	15,159	-	15,159
DKK	10,761	7,761	3,000
Other	19	-	19
Total	78,884	47,396	31,488

Credit risk

The Group is exposed to credit risks when trading in electricity, making investments and trading in derivative contracts. The Group's policy is to primarily use liquid assets to repay loans. Remaining liquidity is invested in part in the short-term (to manage daily variations in the Group's liquidity flows) and in part in the long-term. The Group's long-term investment portfolio is intended to secure legal requirements regarding capital availability for nuclear power operation in Germany. Investments are made in accordance

with established investment rules with counterparts with low credit risks. The proportion of shares in the long-term investment portfolio may not exceed 30 per cent of the assets. As of 31 December, the proportion of shares was 20 per cent. The average interest rate was 3.4 per cent while the average duration was 2.8 years.

Credit risks are managed within the framework of established limits based on external ratings or internal credit assessments. Individual limits are established for each counterpart and each counterpart is regularly reassessed. Exposure is monitored in relation to credit limits on a daily basis.

Prior to long-term agreements being entered into, a general master agreement, such as an ISDA, FEMA or EFET, is required. In the Nordic countries, the majority of financial electricity contracts are settled via Nord Pool and the larger part of the credit risk arising is in the marketplace. In Germany, prices are hedged in a similar manner against EEX, even if OTC trade between bilateral counterparts is also common.

Credit risk

Type of instrument	Exposure
Electricity derivatives, positive fair values	4,259
Electricity derivatives, settlement risk	1,241
Interest and currency derivatives, positive fair values	2,724
Interest-bearing investments including larger bank balances	8,991
Shares	782
Total	17,997

Exposure in interest and currency derivatives adjusted for ISDA agreements or equivalents amounts to SEK 2,724 million. Without adjustment exposure is SEK 5,196 million.

Note 36 Interest-bearing provisions

	Non-current portion		Current portion		Total	
	2005	2004	2005	2004	2005	2004
Provisions for future expenses of nuclear operations	25,919	23,023	154	148	26,073	23,171
Provisions for future expenses of mining operations and other environmental measures/undertakings	8,074	7,306	962	1,112	9,036	8,418
Personnel-related provisions for non-pension purposes	3,980	4,304	1,293	1,583	5,273	5,887
Provisions for tax and legal disputes	3,437	4,191	2,062	1,367	5,499	5,558
Other provisions	1,566	1,797	244	660	1,810	2,457
Total	42,976	40,621	4,715	4,870	47,691	45,491

A discount rate of 5.0 per cent (5.5) has been used for interest-bearing provisions. See also Note 50 of the consolidated accounts.

Provisions for future expenses of nuclear operations:

Vattenfall's nuclear power producers 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 Swedish operations, current estimations indicate that approximately 80 per cent of the provisions will result in disbursements after 2021. The remaining 20 per cent is estimated to result in relatively evenly distributed disbursements over the years 2006–2020.

Existing plans for the decommissioning of the German nuclear power operations entail about 94 per cent of the provisions resulting in cash flows after 2008. For 2006, disbursements are estimated at about 2 per cent of the provisions while disbursements corresponding to the remaining 4 per cent or so are estimated to be evenly distributed over the years 2007–2008.

Provisions for future expenses of nuclear operations (changes in 2005)	Sweden	Germany	Total
Balance brought forward	16,515	6,656	23,171
Provisions for the period	1,551	635	2,186
Discounting effects	888	348	1,236
Provisions used	-805	-157	-962
Reclassified provisions	-	126	126
Reversed provisions	-	-12	-12
Translation differences	-	328	328
Balance carried forward	18,149	7,924	26,073

Provisions for future expenses of mining operations and other environmental measures/undertakings:

Provisions are made for restoring sites and other undertakings connected with the Group's permits for conducting lignite mining in Germany. Provisions are also made for environmental measures/undertakings within other activities carried out by the Group.

According to current assessments, some 75 per cent of the provisions will result in cash outflows later than 2008. For 2006, disbursements are estimated at about 11 per cent of the provisions while disbursements corresponding to the remaining approx. 14 per cent are estimated to be relatively evenly distributed over the years 2007–2008.

Provisions for mining operations etc. (changes in 2005)

Balance brought forward	8,418
Provisions for the period	1,207
Discounting effects	413
Provisions used	-573
Reversed provisions	-837
Translation differences	408
Balance carried forward	9,036

Personnel-related provisions for non-pension purposes:

Provisions are made for future expenditure relating to redundancy in the form of severance pay and other expenditure for giving notice to personnel. The major part of the provisions is related to the essentially completed restructuring of activities in Germany.

Approximately 25 per cent of the provisions that have been made are expected to result in disbursements in 2006 while about 36 per cent is expected to be disbursed in 2007 and 2008. Thereafter, approximately 30 per cent will be relatively evenly distributed over the years 2009–2012.

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Note 37 continued

Personnel-related provisions for non-pension purposes
(changes in 2005)

Balance brought forward	5,887
Acquired companies	1
Provisions for the period	555
Discounting effects	235
Provisions used	-1,483
Reclassified provisions	2
Reversed provisions	-213
Divested companies	-6
Translation differences	295
Balance carried forward	5,273

Provisions for tax and legal disputes:

Provisions are made for possible future tax expenses due to ongoing tax audits and for ongoing legal disputes and actions. These include provisions related to ongoing legal actions concerning encroachment as regards cable laying on land in former East Germany.

Approximately 37 per cent of the provisions for tax and legal disputes are expected to result in disbursements in 2006. The remaining provisions are estimated to result in cash flows during the years 2007–2009 (23 per cent) and 2010–2012 (40 per cent).

Provisions for tax and legal disputes
(changes in 2005)

Balance brought forward	5,558
Provisions for the period	304
Discounting effects	141
Provisions used	-341
Reclassified provisions	199
Reversed provisions	-620
Translation differences	258
Balance carried forward	5,499

Other provisions

Other provisions include, among others, those for losses on contracts, restructuring and guarantee commitments.

Approximately 14 per cent of these provisions are expected to result in disbursements in 2006 while the remaining approximately 65 per cent is expected to result in disbursements during 2007 and 2008.

Other provisions (changes in 2005)

Balance brought forward	2,457
Transition effect on adoption of new accounting principles (IAS 39)	-18
Acquired companies	8
Provisions for the period	309
Discounting effects	8
Provisions used	-690
Reversed provisions	-54
Reclassified provisions	-326
Divested companies	-9
Translation differences	125
Balance carried forward	1,810

Note 37 Pension provisions

Vattenfall's pension obligations in the Group's Swedish and German companies are predominantly defined benefit pension obligations. The concerned pension plans are primarily retirement pensions, disability pensions and family pensions. The assets in these funds, the investment assets, are reported at fair value. There are also pension plans in these and other countries that are defined contribution plans.

The Swedish pension plans supplement the Swedish social insurance system and are the result of agreements between employer organisations and employee organisations. Almost all employees in Sweden are covered by a pension plan that is primarily a defined benefit plan, known as ITP-Vattenfall. This pension plan guarantees employees a pension based on a percentage of their salary. These benefits are secured in a Pension Foundation through provisions in the balance sheet or insurance premiums.

Vattenfall's commitments for retirement pensions and family pensions for white collar employees in Sweden are secured through an insurance policy from Alecta. According to a statement issued by the Swedish Financial Accounting Standards Council's emerging issues task force, URA 42, this plan is a defined benefit plan encompassing several employers. For the 2005 financial year, Vattenfall has not had access to such information as to make it possible to report this plan as a defined benefit plan. The ITP pension plan, which is secured through an insurance policy from Alecta, is therefore reported as a defined contribution plan. Contributions for the year for pension insurance policies from Alecta amount to SEK 130 million (127). Alecta's profit can be distributed between the policyholders and/or the insured parties. At the end of 2005, Alecta's profit in the form of the so-called collective consolidation level amounted to 128 per cent (128). The collective consolidation level comprises the fair value of Alecta's assets as a percentage of the insurance commitments calculated in accordance with Alecta's insurance calculation principles and assumptions, which are not in agreement with IAS 19.

The pension plans in Germany are based on collective agreements in line with market terms and conditions. Substantial defined benefit plans exist in Germany for employees of the companies Bewag and HEW. Bewag has two pension plans, both financed through Pensionskasse der Bewag, a mutual insurance company. This plan is financed through funds from Bewag and its employees. One plan has been assessed as a defined contribution plan and is reported as such as the benefit is dependent on the contributions paid and Pensionskasse der Bewag's financial position. For employees who began their employment before 1 January 1984, there is a supplementary agreement providing employees working until retirement age with a pension equal to up to 80 per cent of the salary on which the pension is based. Half of the statutory pension and the entire benefit from Pensionskasse der Bewag, including profits, are credited to the guaranteed amount. Bewag's obligations encompass the entire pension commitment. The investment assets attributable to personnel employed since before 1 January 1984 are reported as investment assets at fair value. Pension commitments for HEW employees are mainly comprised of the company's commitments to personnel employed before 1 April 1991 and who have been employed for at least 10 years. The sum of the retirement pension, statutory pension and pensions from third-parties normally amounts to a maximum of 65 per cent of the salary on which the pension is based.

Pension obligations are calculated on an actuarial basis in accordance with the Projected Unit Credit Method.

Actuarial gains and losses are taken up as income and expenses respectively and evenly distributed over the employees' remaining employment periods to the extent that the total gain or loss for a particular pension plan falls outside a corridor equal to 10 per cent of the greater of the pension commitment and the fair value of the investment assets for each individual plan.

Pension costs:	2005	2004
Defined benefit plans		
Service cost for the currency year	470	435
Interest expense	1,639	1,670
Expected return on plan assets	-846	-840
Past service cost	73	42
Other	60	25
Total cost for defined benefit plans	1,396	1,332

Cost for defined contribution plans	294	312
Total pension costs	1,690	1,644

Pension costs are reported under the following items in the income statement:

	2005	2004
Cost of products sold	1,063	1,228
Selling expenses	152	89
Administrative expenses	447	304
Research and development costs	28	23
Total pension costs	1,690	1,644

Actual return on plan assets	1,196	1,029
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	Fully or partially funded pension plans	Non-funded pension plans	Actuarial losses	2005
Present value of obligations	18,566	19,049		37,615
Plan assets' fair value	-16,248			-16,248
Unrecognised actuarial losses			-3,935	-3,935
Total pension provisions at year-end	2,318	19,049	-3,935	17,432

	Fully or partially funded pension plans	Non-funded pension plans	Actuarial losses	2004
Present value of obligations	15,261	17,052		32,313
Plan assets' fair value	-14,972			-14,972
Unrecognised actuarial losses			-891	-891
Total pension provisions at year-end	289	17,052	-891	16,450

Pension provisions	2005	2004
Balance brought forward	16,450	14,946
Transition effect on adoption of new accounting principles	-	1,265
Acquired companies	-	86
Cost for defined benefit plans	1,396	1,332
Provisions used	-1,198	-1,214
Reclassifications	-2	143
Translation differences	786	-108
Balance carried forward	17,432	16,450

In calculating pension obligations, the following actuarial assumptions have been made (per cent):

	2005	2004
Discount rate	3.75-4.25	5.0
Expected return on plan assets	4.35-5.25	5.5
Future annual salary increases	2.5-3.5	2.2-3.5
Future annual pension increases	2.0	2.0-2.5

Note 38 Other non-interest-bearing liabilities (non-current)

Of the total liabilities of SEK 2,425 million (2,135), SEK 1,256 million (1,393) falls due after more than five years.

Note 39 Trade and other liabilities

	2005	2004
Advance payments from customers	1,335	689
Accounts payable	9,393	7,591
Liabilities to associated companies	982	361
Derivatives with negative fair values	18,986	-
Other liabilities	3,210	2,768
Total	33,906	11,409

Note 40 Accrued expenses and deferred income

	2005	2004
Accrued personnel-related costs	3,199	2,776
Accrued expenses, carbon dioxide emissions	5,657	-
Accrued expenses, connection fees	254	-
Accrued nuclear power-related fees and taxes	62	108
Accrued interest expense	1,560	776
Other accrued expenses	1,966	4,208
Deferred income and accrued expenses, electricity	3,220	536
Other deferred income	1,475	1,550
Total	17,393	9,954

Note 41 Interest-bearing liabilities (current)

	2005	2004
Bond loans	3,008	2,317
Liabilities to credit institutions	1,028	5,347
Liabilities to minority owners	635	323
Liabilities to associated companies	4,679	833
Other liabilities	180	74
Total	9,530	8,894

Note 42 Pledged assets

	2005	2004
For own liabilities and provisions		
Liabilities to credit institutions:		
Floating charges	-	7
Real estate mortgages	6	5
Blocked bank funds as security for trading on energy exchanges	2,246	220
Other	2	15
Total	2,254	247

Note 43 Contingent liabilities

	2005	2004
Guarantees	1,256	2,629
Other contingent liabilities	9,738	4,033
Swedish Nuclear Waste Fund	5,377	3,779
Total	16,371	10,441
Other contingent liabilities		
Compensatory and free power deliveries:		
Wholesale power deliveries		
Number of commitments	13	13
Power MW	223	217
Energy deliveries, TWh/year	0.9	0.9

On some rivers, several hydro power stations share regulation facilities. The owners of the stations are each liable for their share of the regulation costs.

Under Swedish law, Vattenfall has a strictly unlimited liability for third-party damages resulting from dam accidents. Together with other hydro power producers in Sweden, Vattenfall has taken out liability cover which will pay out a maximum of SEK 6,000 million for this type of damages.

As a natural part of the Group's business and in addition to the obligations specified above, guarantees are put in place for the fulfilment of various contractual obligations.

Within its German operations, Vattenfall conducted a number of leasing transactions involving power plants in 1999 and 2000. The basis for the transactions is the right of use of power plants leased to US counterparts as part of so-called head leases, lasting a maximum of 99 years, and thereafter leased back for 24 years as part of so-called subleases. After the subleases expire, Vattenfall has the right to regain the right of use through a call option. Rent from the US counterparts has been received in advance and has been deposited in financial institutions with high credit ratings for the payment of sums due in accordance with the subleases, including payment of the options. The net difference between rental payments received and deposits made has been reported as a net figure at the time the lease contracts were entered. Should the leasing parties or the underlying customers fail to meet their obligations during the leasing period, this will incur termination costs for Vattenfall. On closing day, these obligations amounted to a maximum of SEK 1,392 million, which is included in the reported contingent liabilities.

Within its Swedish operations, Vattenfall conducted a number of leasing transactions involving power plants in 2003 and 2005. The transactions are based on sale and lease-back agreements for each power plant, which were sold to French counterparts to be rented back for 15 years. Once the leasing periods expire, Vattenfall has the right to purchase the plants via call options. Income from the sale to the French counterparts has been deposited with financial institutions with high

credit ratings for the disbursement of the leasing payments, including the sums for the options. Should Vattenfall wish to prematurely redeem the leasing agreements, this would incur costs for Vattenfall. On the balance sheet date, these costs amounted to a maximum of SEK 97 million.

In Germany, nuclear power operators have unlimited liability. The combined mandatory insurance coverage for all these operators is EUR 2,500 million. Claims of up to EUR 256 million are covered by the German Mutual Atomic Energy Reinsurance Pool. Claims in excess of EUR 256 million up to a maximum of EUR 2,500 million are covered by a joint liability insurance agreement (Solidarvereinbarung) between the German nuclear power plant operators. The Vattenfall Group's share of this joint liability insurance agreement comprises, as of 1 January 2006, EUR 169.93 million per claim and entails an obligation to keep available liquid assets corresponding to twice this amount, that is, EUR 339.86 million.

Vattenfall AB and Vattenfall Europe AG have provided security for the energy trading conducted by the subsidiary Vattenfall Europe Trading GmbH consisting of guarantees to a total value of EUR 852 million. On the balance sheet date, guarantees totalling EUR 390 million, equal to SEK 3,679 million, were pledged and are included in the reported contingent liabilities.

According to Swedish law, nuclear power companies in Sweden shall pledge assets to the Swedish state (Swedish Nuclear Waste Fund) to guarantee that sufficient funds exist to cover the future expenses of nuclear waste management. The assets are pledged as guarantee commitments issued by the owners of the nuclear power companies. The assets shall in part cover the fees in case a particular reactor is operated for less than 25 years and in part cover any shortage in fund capital should the fund's assets prove insufficient to decommission and dismantle the reactors and manage the spent nuclear fuel. Vattenfall AB has made guarantee commitments totalling SEK 5,377 million for Ringhals AB and Forsmarks Kraftgrupp AB, both of which are members of the Vattenfall group.

Note 44 Commitments under consortium agreements

Power plants are often built on a joint venture basis. Under the consortium agreements, each owner is entitled to electricity in proportion to its share of ownership, and each owner is liable, regardless of output, for an equivalent proportion of all the joint venture's costs.

Vattenfall's investments in heating companies and other businesses often entail a liability for costs in proportion to its share of ownership.

Vattenfall bears full financial responsibility for SwePol Link up to July 2020.

Note 45 Average number of employees and personnel costs

Average number employees	2005			2004		
	Men	Women	Total	Men	Women	Total
Sweden	6,459	1,891	8,350	6,386	1,806	8,192
Finland	341	205	546	343	200	543
Germany	15,532	4,667	20,199	16,046	4,818	20,864
Poland	2,297	734	3,031	2,482	827	3,309
Other countries	85	20	105	86	23	109
Total	24,714	7,517	32,231	25,343	7,674	33,017

Personnel costs	2005	2004
Salaries and other remuneration	13,371	12,684
Social security expenses	5,293	4,402
(of which pension commitments) ¹	(2,115)	(1,174)
Total	18,664	17,086

1) SEK 80 million (59) of the pension costs are attributable to the group comprising presidents and vice presidents and former presidents and vice presidents. The Group's outstanding pension obligations attributable to these officers total SEK 423 million (374).

Salaries and other remuneration	2005			2004		
	Board members and senior executive officers ¹	Other employees	Total	Board members and senior executive officers ¹	Other employees	Total
Sweden	66	3,397	3,463	42	3,323	3,365
Finland	4	213	217	4	198	202
Germany	81	9,135	9,216	192	8,468	8,660
Poland	19	443	462	36	409	445
Other countries	–	13	13	–	12	12
Total²	170	13,201	13,371	274	12,410	12,684

Social security expenses	2005	2004
Sweden	1,838	905
Finland	52	46
Germany	3,304	3,348
Poland	96	101
Other countries	3	2
Total	5,293	4,402

- 1) Board members and senior executive officers also include alternates, vice presidents and former Board members, alternates, presidents and vice presidents.
- 2) Total salaries and other remuneration to Board members and presidents include bonuses of SEK 41 million (34).

Benefits to Board members and senior executive management of Vattenfall AB

SEK thousands	Board remuneration and basic salary 2005 including holiday pay	Company car and other remuneration 2005	Pension costs 2005	Estimated variable remuneration for 2005 to be paid 2006
Dag Klackenborg, Chairman of the Board	413	–	–	–
Maarit Aarni, Board member	207	–	–	–
Carl-Gustaf Angelin, Board member	39	–	–	–
Johnny Bernhardsson, Board member	39	–	–	–
Christer Bådholm, Board member	257	–	–	–
Ronny Ekwall, Board member	39	–	–	–
Peter Fallenius, Board member (until 16 February 2005)	42	–	–	–
Jan Grönlund, Board member (until 26 April 2005)	67	–	–	–
Peter Lindell, Board member	257	–	–	–
Hans-Olov Olsson, Board member	207	–	–	–
Lone Fønss Schrøder, Board member	240	–	–	–
Anders Sundström, Board member	207	–	–	–
Lars Carlsson, Alternate	39	–	–	–
Stig Lindberg, Alternate	39	–	–	–
Per-Ove Lööv, Alternate	52	–	–	–
Lars G Josefsson, CEO, President	7,202	111	5,562	–
Matts Ekman, First Senior Executive Vice President, CFO	2,968	104	2,311	602
Klaus Rauscher, Senior Executive Vice President	6,734	49	475	2,886
Hans von Uthmann, Senior Executive Vice President	3,164	70	786	631
Tuomo Hatakka, Senior Executive Vice President (from 1 August 2005)	2,080	27	481	687
Alf Lindfors, Executive Vice President	2,592	117	5,366	510
Mats Fagerlund, Executive Vice President	3,397	1,077	1,882	3,387
Lennart Billfalk, Executive Vice President	2,170	65	4,733	432
Ann-Charlotte Dahlström, Senior Vice President Personnel	2,203	76	2,234	440
Knut Leman, Senior Vice President Communications	1,841	96	1,958	367
Magnus Groth, Executive Vice President (until 31 August 2005)	1,295	37	221	–
Total	37,790	1,829	26,009	9,942

Board of Directors

In 2005, the Chairman of the Board received remuneration in the amount of SEK 413 thousand while other Board members received remuneration totalling SEK 1,576 thousand (breakdown shown in the table above).

The four Board members in the internal Audit Committee also received remuneration as follows: SEK 50 thousand each for those not employed by Vattenfall and SEK 13 thousand for the employee representative Board member holding this position in 2005. These

amounts are included in the table above under the heading Board remuneration.

Chief Executive Officer and President

In 2005, Lars G Josefsson, who is Chief Executive Officer and President of Vattenfall AB, received a salary and other remuneration, including the value of a company car, amounting to SEK 7,313 thousand. As of 2005, the President no longer receives any variable salary.

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Note 45 continued

Lars G Josefsson, who was born in 1950, is entitled to retire at the age of 60. A retirement pension of 65 per cent of his salary upon retirement will be paid up to the age of 65. After this, retirement benefits will be paid corresponding to the applicable ITP benefit plan plus 32.5 per cent of the portion of his salary exceeding 30 basic amounts (a basic amount is a standard amount used for Swedish social security purposes). The latter retirement benefit has a time limit and is payable up to the age of 80. After the age of 76, it decreases by a fifth for each consecutive year and ceases completely at the age of 80. The pension commitment is covered by premiums paid to an insurance company on a regular basis. The benefits are vested, that is, not conditional on future employment. In the event of termination of employment by Vattenfall, the CEO is entitled to severance pay corresponding to a maximum of 24 months' salary. However, severance pay may only be paid until the contractual retirement age. The size of the severance pay will be calculated on the basis of the fixed salary at the time of termination of employment. In the event of new employment or income from another source, the severance pay will be reduced by an amount corresponding to the new income or other benefits received during the period in question. Severance pay is paid monthly.

Other executive management

For other members of executive management who have been part of Executive Group Management, a total of 10 people, the total sum of salary and other remuneration, including the value of company cars, was SEK 30,162 thousand.

In the case of the First Senior Executive Vice President, a premium-based pension solution applies with a retirement age of 60.

In the case of Dr. Klaus Rauscher, remuneration for pension benefits is paid as a salary supplement.

In the case of Tuomo Hatakka, a premium-based pension solution applies.

For other members of Executive Group Management retirement age varies between 60 and, for those employed after 1 October 2003, 62. For those with the opportunity to retire at 60, between the ages of 60 and 65 years, 70 per cent of the fixed salary is paid. Variable salary provides absolutely no basis for pensions between the ages of 60 and 65. The ITP plan applies from the age of 65, together with a supplementary pension, a so-called extension. The extension consists of 32.5 per cent of the part of the salary upon which the pension is based in excess of 20 basic amounts. Salary upon which the pension is based comprises basic salary and annual variable salary, in accordance with ITP. Service pension from age 65 is between 44 and 49 per cent of the fixed salary.

In those cases where the pension applies from age 62, ITP is applied with a so-called extension, equal to 32.5 per cent of salary in excess of 30 basic amounts. Furthermore, the average of the past five years' fixed salaries provides a basis for the pension, while variable salary is not included in the calculation. The pension from age 62 is about 40 per cent of the fixed salary. All pension benefits are vested, that is, not conditional on future employment. For these other members of Executive Group Management, premiums were paid to Alecta and ITP-K in amounts varying from SEK 150 thousand to SEK 190 thousand. The remainder of the pension costs, the major part, is an actuarially calculated cost comprised of the ITP liability and the annual change in the capital value of the portions over and above ITP. This is posted as a liability and secured through Vattenfall's Pension Foundation.

In two cases, alternative ITP applies, wherein premiums are paid instead of the equivalent amount being posted as a liability. The so-called extension over and above ITP, as described above, is also applied. For these members of senior management, if employment is terminated by the company, they are entitled to their salary during the contractual period of notice (6 months), plus severance pay comprising 18 months' salary, which is paid monthly with a deduction for the amount corresponding to new income during the

period in question. Both Dr. Klaus Rauscher and Tuomo Hatakka, however, have fixed-term employment contracts.

Preparatory and decision processes

It is the Board as a whole that decides on the remuneration paid to the Chief Executive Officer following a proposal from the Chairman of the Board. For other members of management, the Chief Executive Officer decides on remuneration following consultations with the Chairman of the Board and after informing the Board.

Incentive programme 2005

In light of of the Swedish government's guidelines on remuneration to executive management and incentive programmes, the Board of Vattenfall AB has adopted a programme which as of 2005 applies in the Swedish part of operations and to employees in Sweden.

In line with the Swedish government's guidelines, the Group President no longer receives any variable salary. Regarding other managers and employees, variable salary may not exceed the equivalent of two monthly salaries a year, or 16.7 per cent of the normal fixed salary. The maximum level for most employees averages about SEK 17 thousand per year.

As before, the basis of the incentive programmes continues to be the Group's long-term value-creation¹. The Group goal is common to all. Further, the result of each unit and individual is measured.

In other countries, Finland, Poland and Germany, the same Group goal of value creation is used in agreements on variable salary for senior managers and other concerned employees.

¹ Value creation = the positive change in operating profit less the required return on average net assets, where the required return is 11 per cent.

Note 46 Gender distribution among executive management

	Women, %		Men, %	
	2005	2004	2005	2004
Gender distribution among Board members	10	5	90	95
Gender distribution among other executive management	11	11	89	89

Note 47 Leasing

Leasing expenses

Equipment leased by the Group through financial leases and reported as property, plant and equipment comprises:

	2005	2004
Machinery/Equipment		
Cost	256	382
Accumulated depreciation according to plan	-61	-106
Impairment losses	-37	-67
Residual value according to plan	158	209

Future payment commitments, as of 31 December 2005, for leasing contracts and rental contracts break down as follows:

	Financial leasing, nominal	Financial leasing, present value	Operating leasing
2006	59	58	524
2007	34	33	444
2008	27	25	381
2009	27	23	356
2010	37	30	349
2011 and beyond	375	260	1,760
Total	559	429	3,814

The current year's leasing expenses for Group assets amounted to SEK 630 million (594).

Leasing revenues

Certain Group companies own and operate power facilities on behalf of customers. Revenues from customers breaks down into two components – a fixed component to cover capital expenses and a variable component based on the quantity delivered.

Facilities are classified in accordance with standard leasing principles, based on the fixed revenue component.

On 31 December 2005, cost of assets reported under Operating leasing amounted to SEK 2,049 million (1,673). Accumulated depreciation amounted to SEK –762 million (–554) and accumulated impairment losses to SEK –30 million (–30).

Future payments for this type of facility break down as follows:

	Financial leasing	Operating leasing
2006	1	161
2007	1	153
2008	1	147
2009	1	135
2010	1	110
2011 and beyond	5	402
Less: Financial income	–4	–175
Total	6	933

Note 48 Remuneration to auditors etc.

	2005	2004
Statutory audit		
Ernst & Young ¹	23	16
PricewaterhouseCoopers ²	10	11
BDO	12	11
Swedish National Audit Office	1	1
Other	1	–
Total	47	39
Other remuneration		
Ernst & Young ³	15	12
PricewaterhouseCoopers ⁴	13	14
BDO	5	6
Total	33	32

1) In addition to the parent company's audit expenses of SEK 7 million (6), these expenses are attributable to audits of Swedish, Finnish, German and Polish companies.

2) These amounts are primarily attributable to audits in German companies.

3) SEK 8 million (6) of the Group's remuneration expenses is attributable to operations in Germany and Poland.

4) SEK 11 million (11) of the Group's remuneration expenses is attributable to operations in Germany.

Note 49 Transactions with related parties

Vattenfall AB is wholly owned by the Swedish state. The Vattenfall Group's products and services are offered to the Swedish state, Swedish state authorities and Swedish state companies in competition with other suppliers and under generally accepted commercial terms. In a similar manner, Vattenfall AB and its Group companies purchase products and services from Swedish state authorities and companies at market prices and otherwise under generally accepted commercial terms. No significant share of the Vattenfall Group's net sales or profits is attributable to the Swedish state or any of its authorities and companies.

Note 50 Important estimations and assessments

The negotiations between Vattenfall and the Swedish state on compensation to Vattenfall for the closure of Barsebäck 2 were finalised in November 2005. The agreement has been approved by the Swedish government, the Board of E.ON Sverige AB and the Board of Vattenfall AB. The approval of Malmö district court is expected in spring 2006. Due to the closing, the Vattenfall Group will receive compensation for future production losses amounting to SEK 4,100 million, which is reported under the "Other operating income" in the consolidated income statement. Vattenfall's impairment losses of assets attributable to Barsebäck Kraft AB amount to SEK 1,043 million, which has burdened the consolidated income statement for 2005.

The various provisions made in the consolidated balance sheet have been reviewed. This review has led to changes in earlier assumptions about discount rates in the calculation of these provisions. For pension provisions, the discount rate was adjusted from 5.0 per cent to 3.75 per cent for the pension plans in Sweden and from 5.5 per cent to 4.25 per cent for the pension plans in Germany. For other provisions, the discount rate has been adjusted from 5.5 per cent to 5.0 per cent. As a result, the provisions have increased by SEK 2,588 million. The Group's operating profit for 2005 has been burdened in the amount of SEK 650 million.

Note 51 Events after the balance sheet date

On 31 January 2006, the Board of Vattenfall AB decided to extend the depreciation period for the Swedish nuclear power plants from 25 to 40 years. This decision has no retroactive effect.

In February 2006, the Swedish network regulator (Elmarknadsinspektionen, EMI) ordered Vattenfall to repay SEK 236 million in network tariffs for 2003, which Vattenfall will appeal.

In February 2006, Vattenfall's Revolving Credit Facility was renegotiated and increased from EUR 600 million to EUR 1,000 million. The term was extended to 2013.

THE PARENT COMPANY

Parent company income statement

Amounts in SEK millions, 1 January–31 December	Note	2005	2004
Net sales	4, 5	26,843	26,046
Cost of products sold	6	-16,415	-16,134
Gross profit		10,428	9,912
Selling expenses		-872	-752
Administrative expenses		-1,320	-1,243
Research and development costs		-165	-142
Other operating income	7	162	94
Other operating expenses	8	-90	-31
Operating profit	9	8,143	7,838
Result from participations in Group companies	10	414	1,121
Result from participations in associated companies	11	26	23
Results from other long-term securities holdings	12	-3	445
Interest income and similar profit/loss items	13	1,853	1,571
Interest expenses and similar profit/loss items	14	-6,037	-2,018
Group contributions		1,771	2,522
Profit before appropriations and tax		6,167	11,502
Appropriations	15	-709	-2,127
Profit before tax		5,458	9,375
Income tax expense	16	-1,873	-2,340
Profit for the year		3,585	7,035

Parent company balance sheet

Amounts in SEK millions	Note	31 Dec 2005	31 Dec 2004
Assets			
Non-current assets			
Intangible assets			
Capitalised development costs	17	237	-
Concessions, patents, licences, trademarks and similar rights		10	13
Renting and similar rights		23	25
Total intangible assets		270	38
Property, plant and equipment			
Land and buildings	18	11,009	10,973
Plants and machinery and other technical installations		7,147	7,234
Equipment, tools, and fixtures and fittings		33	35
Construction in progress		1,224	1,919
Total property, plant and equipment		19,413	20,161
Financial non-current assets			
Participations in Group companies	19, 20	41,742	40,533
Receivables from Group companies	21	4,316	4,335
Participations in associated companies	19, 20	10,860	540
Receivables from associated companies	21	2,183	1,790
Other long-term securities holdings	19, 20	37	55
Deferred tax assets	16	63	81
Other non-current receivables	21	261	148
Total financial non-current assets		59,462	47,482
Total non-current assets		79,145	67,681
Current assets			
Inventories	22	296	278
Current receivables	23	43,488	31,111
Cash and cash equivalents	24	2,360	142
Total current assets		46,144	31,531
Total assets		125,289	99,212
Equity, provisions and liabilities			
Equity			
Restricted equity			
Share capital (131,700,000 shares with at a par value of SEK 50)		6,585	6,585
Statutory reserve		1,286	1,286
Non-restricted equity			
Retained earnings		12,496	10,043
Profit for the year		3,585	7,035
Total equity		23,952	24,949
Untaxed reserves	15	14,978	14,269
Provisions	25	120	86
Non-current interest-bearing liabilities			
Non-current non-interest-bearing liabilities	26	58,700	40,398
Liabilities	27	2,826	2,818
Total non-current liabilities		61,526	43,216
Current interest-bearing liabilities			
Current tax liabilities	28	10,383	5,251
Other current non-interest-bearing liabilities	16	156	1,280
Liabilities	29	14,174	10,161
Total current liabilities		24,713	16,692
Total equity, provisions and liabilities		125,289	99,212
Pledged assets	30	2,246	20
Contingent liabilities	31	95,122	79,251
Commitments under consortium agreements	32		

PARENT COMPANY NOTES

(Amounts in SEK millions unless otherwise stated.)

Parent company statement of changes in equity

Amounts in SEK millions	Share capital	Statutory reserve	Non-restricted equity	Total
Balance brought forward 2004	6,585	1,286	12,017	19,888
Dividend to shareholders	-	-	-2,400	-2,400
Group contributions	-	-	43	43
Tax effect of Group contributions	-	-	-12	-12
Result from mergers	-	-	395	395
Profit for the year	-	-	7,035	7,035
Balance carried forward 2004	6,585	1,286	17,078	24,949
Dividend to shareholders	-	-	-5,600	-5,600
Group contributions	-	-	-136	-136
Tax effect of Group contributions	-	-	38	38
Result from mergers	-	-	1,116	1,116
Profit for the year	-	-	3,585	3,585
Balance carried forward 2005	6,585	1,286	16,081	23,952

As of 31 December 2005 the registered share capital comprised 131,700,000 shares at a par value of SEK 50 each.

Parent company cash flow statement

Amounts in SEK millions, 1 January-31 December	2005	2004
Operating activities		
Funds from operations (FFO)		
Profit for the year	3,585	7,035
Adjustments for the effects of items not included in the cash flow:		
Income tax expense	1,873	2,340
Appropriations	709	2,127
Depreciation and amortisation	731	752
Dividend-contingent Group contributions	-1,771	-2,523
Change in tax liabilities and tax assets	-1,142	-1,071
Unrealised exchange rate effects	1,852	-426
Increase in provisions	34	19
Other	-150	815
Cash flow from changes in operating assets and operating liabilities	-11,827	-11,821
Cash flow from operating activities	-6,106	-2,753
Investment activities		
Investments in Group companies, associated companies and other long-term securities holdings	-11,607	-2,244
Investments in property, plant and equipment and intangible assets	-1,445	-1,427
Divestments of property, plant and equipment	1,166	40
Divestments of shares and participations	157	451
Cash flow from investment activities	-11,729	-3,180
Cash flow before financing activities	-17,835	-5,933
Financing activities		
Loans raised	23,133	6,275
Group contributions received	2,520	2,167
Dividend paid to shareholders	-5,600	-2,400
Cash flow from financing activities	20,053	6,042
Cash flow for the year	2,218	109
Cash and cash equivalents		
Cash and cash equivalents at the beginning of the year	142	33
Cash flow for the year	2,218	109
Cash and cash equivalents at the end of the year	2,360	142

Interest paid totalled SEK 2,519 million (1,754) and interest received totalled SEK 806 million (842). Tax paid totalled SEK 3,015 million (1,071).

Note 1 Company information

The Annual Report for Vattenfall AB for 2005 has been approved in accordance with a decision by the Board of Directors of 22 February 2006. Vattenfall AB, which is the parent company in the Vattenfall Group, is a limited liability company with its registered office in Stockholm and with the address SE-162 87 Stockholm, Sweden. The balance sheet and income statement of the parent company will be adopted at the annual general meeting (AGM).

Note 2 Accounting principles

General

The parent company Vattenfall AB's accounts have been prepared in accordance with the Swedish Annual Accounts Act and the recommendations of the Swedish Financial Accounting Standards Council.

The accounting principles applied are stated in the applicable parts of Note 2 of the consolidated accounts with the following amendments for the parent company Vattenfall AB. The parent company does not apply IAS 39 concerning financial instruments.

New accounting principles

The Swedish Financial Accounting Standards Council's recommendation RR 32 – Reporting for Legal Entities came into force on 1 January 2005 and shall be applied by legal entities whose securities are listed on a Swedish stock exchange or other authorised market on the balance sheet date. In the case of the consolidated accounts such Swedish companies shall apply the EU regulation on international accounting principles while continuing to apply the Swedish Annual Accounts Act in the preparation of the legal entity's accounts. RR 32 states that in general Swedish listed companies shall apply the IFRS applied in the consolidated accounts and specify the exceptions and amendments due to legal provisions, primarily the Swedish Annual Accounts Act, and the connection between statutory financial reporting and the reporting for tax purposes. Vattenfall AB already applies the recommendations of RR 32.

Depreciation and amortisation

Depreciation/amortisation is calculated, as in the consolidated accounts, from cost and is applied on a straight-line basis over the estimated useful life of the asset. In addition, certain accelerated depreciation/amortisation (the difference between depreciation/amortisation according to plan and depreciation/amortisation for tax purposes) in the parent company is reported under appropriations and untaxed reserves respectively.

Pension provisions

Pension obligations in the parent company are calculated in accordance with generally accepted Swedish actuarial principles. The provision reported in the balance sheet corresponds to these pension obligations, entered net against the available capital in Vattenfall's Pension Foundation.

Income tax expense

Tax legislation in Sweden allows companies to defer tax payments by making provisions to untaxed reserves. In the parent company, untaxed reserves are reported as a separate item in the balance sheet that includes deferred tax. In the parent company's income statement, provisions to untaxed reserves and dissolution of untaxed reserves are reported under "Appropriations".

The recognised income tax expense of the parent company, Vattenfall AB, consists of income tax on profit after appropriations.

Note 3 Exchange rates

See Note 6 of the consolidated accounts.

Note 4 Net sales

	2005	2004
Sales including indirect taxes	29,105	28,104
Indirect taxes	-2,262	-2,058
Net sales	26,843	26,046

Net sales per geographic area

	2005	2004
Nordic Countries	25,723	24,960
Germany	739	717
Poland	321	311
Other	60	58
Total	26,843	26,046

Net sales per segment

	2005	2004
Electricity Generation	6,834	6,631
Electricity Market	17,656	17,132
Heat	2,253	2,186
Other	100	97
Total	26,843	26,046

Note 5 Intra-Group transactions

Of the parent company's total income from sales and total purchase costs, transactions with Group companies account for 9 per cent (11) of sales and 52 per cent (51) of purchase costs.

Note 6 Cost of products sold

Direct costs include production taxes and duties of SEK 191 million (210) and property taxes of SEK 260 million (233).

Note 7 Other operating income

Other operating income primarily comprises capital gains from the sale of non-current assets, rental income, insurance compensation and operationally derived foreign exchange gains.

Note 8 Other operating expenses

Other operating expenses primarily consists of capital losses on divestments of non-current assets and operationally derived exchange rate losses.

Note 9 Depreciation and amortisation

	2005	2004
Cost of products sold	721	742
Selling expenses	8	9
Administrative expenses	2	1
Total	731	752

Note 10 Result from participations in Group companies

	2005	2004
Dividends	351	2,384
Impairment losses	-11	-1,263
Capital gains/losses on divestments	74	-
Total	414	1,121

Note 11 Result from participations in associated companies

Fully attributable to dividends from associated companies totalling SEK 26 million (23).

Note 12 Result from other long-term securities holdings

	2005	2004
Dividends	2	1
Impairment losses	-1	-5
Capital gains/losses on divestments	-4	449
Total	-3	445

Note 13 Interest expenses and similar profit/loss items

	2005	2004
Interest income from subsidiaries	362	563
Other interest income	444	280
Foreign exchange gains	1,047	728
Total	1,853	1,571

Note 14 Interest expenses and similar profit/loss items

	2005	2004
Interest expenses to subsidiaries	2,494	1,733
Other interest expenses	25	22
Foreign exchange losses	3,518	263
Total	6,037	2,018

Note 15 Appropriations and untaxed reserves

	Balance brought forward	Provision/Dis-solution (-)	Balance carried forward
Accelerated depreciation	6,601	-186	6,415
2000 Tax allocation reserve	842	-842	0
2001 Tax allocation reserve	464	-	464
2002 Tax allocation reserve	1,371	-	1,371
2003 Tax allocation reserve	963	-	963
2004 Tax allocation reserve	1,295	-	1,295
2005 Tax allocation reserve	2,733	-	2,733
2006 Tax allocation reserve	-	1,737	1,737
Total	14,269	709	14,978

Note 16 Income tax expense

The reported income tax expense breaks down as follows:

	2005	2004
Current tax	1,855	2,335
Deferred tax	18	5
Total	1,873	2,340

The income tax expense for the year attributable to previous years amounts to SEK -396 million (-52). Deferred tax assets according to the balance sheet amount to SEK 63 million (81). Current tax liabilities amount to SEK 156 million (1,280). The tax effect of the standard tax interest on tax allocation reserves amounts to SEK 61 million (0).

The difference between the nominal Swedish tax rate and the effective tax rate is explained in the following manner:

Per cent	2005	2004
Swedish income tax rate	28.0	28.0
Appropriations	-3.2	-5.2
Tax adjustment for previous periods	6.4	0.5
Standard interest rate on tax allocation reserves	1.0	0.0
Non-taxable income	-2.6	-6.3
Non-deductible expenses	1.1	3.3
Other	-0.3	0.1
Effective tax rate¹	30.4	20.4
Tax rate, current tax ²	30.1	20.3

1) Tax expense according to the parent company's income statement in relation to profit before appropriations and tax.

2) Tax expense according to the parent company's income statement excluding reported deferred tax in relation to profit before appropriations and tax.

Note 17 Intangible assets

	Capitalised development costs		Goodwill		Concessions and similar rights		Renting and similar rights		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Acquisition values										
Acquisition values brought forward	-	-	13	13	340	354	61	64	414	431
Investments	161	-	-	-	-	-	-	-	161	0
Divestments/Disposals	-	-	-	-	-	-	-	-3	0	-3
Reclassifications	76	-	-	-	4	-14	-	-	80	-14
Accumulated acquisition value carried forward	237	0	13	13	344	340	61	61	655	414
Accumulated depreciation according to plan										
Depreciation brought forward	-	-	-13	-13	-327	-323	-36	-5	-376	-341
Depreciation for the year	-	-	-	-	-7	-7	-2	-32	-9	-39
Divestments/Disposals	-	-	-	-	-	-	-	1	0	1
Reclassifications	-	-	-	-	-	3	-	-	0	3
Accumulated depreciation carried forward	0	0	-13	-13	-334	-327	-38	-36	-385	-376
Residual value according to plan carried forward	237	0	0	0	10	13	23	25	270	38
Accumulated accelerated depreciation	-71	-	-	-	-10	-13	-23	-25	-104	-38
Book value	166	0	0	0	0	0	0	0	166	0

Note 18 Property, plant and equipment

	Buildings and land ¹		Plants and machinery and other technical installations		Equipment, tools, and fixtures and fittings		Construction in progress		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Cost										
Cost brought forward	16,422	16,147	14,867	13,528	176	170	1,919	454	33,384	30,299
Merged plants	-	237	-	1,120	-	13	-	497	0	1,867
Investments	-	-	2	-	12	9	1,270	1,418	1,284	1,427
Transfer from construction in progress	684	45	953	389	1	-	-1,896	-434	-258	0
Divestments/Disposals	-485	-7	-946	-184	-23	-16	-4	-	-1,458	-207
Reclassifications	-9	-	236	14	-	-	-65	-16	162	-2
Accumulated cost carried forward	16,612	16,422	15,112	14,867	166	176	1,224	1,919	33,114	33,384
Accumulated depreciation according to plan										
Depreciation brought forward	-5,449	-5,087	-7,633	-6,659	-141	-136	-	-	-13,223	-11,882
Merged plants	-	-129	-	-647	-	-7	-	-	0	-783
Depreciation for the year	-239	-235	-470	-465	-13	-13	-	-	-722	-713
Divestments/Disposals	83	2	138	145	21	15	-	-	242	162
Reclassifications	2	-	-	-7	-	-	-	-	2	-7
Accumulated depreciation carried forward	-5,603	-5,449	-7,965	-7,633	-133	-141	0	0	-13,701	-13,223
Residual value according to plan carried forward	11,009	10,973	7,147	7,234	33	35	1,224	1,919	19,413	20,161
Accumulated accelerated depreciation	-	-	-6,278	-6,053	-33	-30	-	-	-6,311	-6,083
Book value	11,009	10,973	869	1,181	0	5	1,224	1,919	13,102	14,078

1) Cost for land and buildings includes cost for land and water rights amounting to SEK 6,618 million (6,695), which are not subject to depreciation.

Tax assessment values (for Swedish real estate)

	2005	2004
Buildings	34,389	34,067
Land	20,970	20,973
Total	55,359	55,040

Distribution lines and transformer stations are not subject to tax assessment values.

Note 19 Participations in Group companies, associated companies and other long-term securities holdings

	Participations in Group companies		Participations in associated companies		Other long-term securities holdings	
	2005	2004	2005	2004	2005	2004
Balance brought forward	40,533	40,532	540	538	55	58
Investments/acquisitions	1,276	2,244	10,331	-	-	2
Shareholders' contributions ¹	-	2	-	2	-	-
Divestments ¹	-56	-2	-4	-	-23	-1
Reclassifications	-	-	-7	-	7	-
Merged shareholdings	-	-977	-	-	-	-
Impairment losses	-11	-1,266	-	-	-2	-4
Balance carried forward	41,742	40,533	10,860	540	37	55

1) Shareholders' contributions and divestments are mainly attributable to restructuring in the Group.

Note 20 Shares and participations

For a breakdown of the parent company's shares and participations in Group companies, associated companies and other long-term securities holdings, see Notes 23–25 of the consolidated accounts.

Note 21 Receivables from Group companies, associated companies and other non-current receivables

	Receivables from Group companies		Receivables from associated companies		Other non-current receivables	
	2005	2004	2005	2004	2005	2004
Balance brought forward	4,335	4,022	1,790	1,909	148	132
New receivables	260	313	1	12	122	30
Payments received	-	-	-49	-117	-2	-14
Reclassifications	-279	-	441	-14	-7	-
Balance carried forward	4,316	4,335	2,183	1,790	261	148

Note 22 Inventories

	2005	2004
Emission allowances	36	-
Oil	154	158
Coal	10	100
LPG	1	-
Peat	47	-
Biofuel	28	-
Materials and spare parts	20	20
Total	296	278

Note 23 Current receivables

	2005	2004
Accounts receivable-trade	2,717	2,678
Receivables from Group companies	34,421	23,122
Receivables from associated companies	55	2,028
Other receivables	4,209	1,803
Prepaid expenses and accrued income	2,086	1,480
Total	43,488	31,111

Breakdown of prepaid expenses and accrued income:

	2005	2004
Prepaid insurance premiums	9	10
Prepaid expenses, other	163	110
Prepaid expenses and accrued income, electricity	1,839	516
Accrued income, other	75	844
Total	2,086	1,480

Note 24 Cash and cash equivalents

The parent company's cash and bank balances are administered by the subsidiary Vattenfall Treasury AB. Funds in the Group account amounted to SEK 30,892 million (22,533) and are reported in the balance sheet as current receivables from Group companies. The parent company's external cash and bank balances amount to SEK 2,360 million (142).

Note 25 Provisions

	2005	2004
Pension provisions	-	10
Personnel-related provisions for non-pension purposes	120	76
Total	120	86
	2005	2004
Pension obligations ¹	2,617	2,606
Less: Capital in pension funds	-2,617	-2,596
Total pension provisions at year-end	0	10
1) Information registered by PRI	1,530	1,493

Note 26 Non-current interest-bearing liabilities

Fully attributable to liabilities to Group companies in the amount of SEK 58,700 million (40,398), of which SEK 18,615 million (8,923) fall due after more than five years.

Liabilities to Group companies are mainly attributable to long-term borrowings from Vattenfall Treasury AB.

Virtually all borrowings in foreign currencies are hedged.

Note 27 Non-current non-interest bearing liabilities

	2005	2004
Liabilities to Group companies	2,134	2,508
Other liabilities	692	310
Total	2,826	2,818

Liabilities to Group companies are mainly attributable to long-term liabilities to Forsmarks Kraftgrupp AB and others for power charges. For the latter liability there shall be, in accordance with an agreement between the co-owners, no interest payable on the debt. Of other liabilities, SEK 333 million (78) falls due after more than five years.

Note 28 Current interest-bearing liabilities

Fully attributable to liabilities to Group companies totalling SEK 10,383 million (5,251).

Note 29 Other current non-interest-bearing liabilities

	2005	2004
Advance payments from customers	37	9
Accounts payable-trade	629	534
Liabilities to Group companies	12,013	8,179
Liabilities to associated companies	29	27
Other liabilities	606	578
Accrued expenses and deferred income	860	834
Total	14,174	10,161

Breakdown of accrued expenses and deferred income:

	2005	2004
Accrued personnel-related costs	215	247
Other accrued expenses	352	533
Deferred income and accrued expenses, electricity	287	32
Other deferred income	6	22
Total	860	834

Note 30 Pledged assets

	2005	2004
Blocked bank funds as security for trading on Nord Pool	2,246	19
Other	-	1
Total	2,246	20

Note 32 Commitments under consortium agreements

See Note 44 of the consolidated accounts.

Note 33 Average number of employees and personnel costs

	2005			2004		
	Men	Women	Total	Men	Women	Total
Average number employees						
Sweden	810	296	1,106	955	494	1,449
Other countries	3	-	3	2	1	3
Total	813	296	1,109	957	495	1,452

	2005	2004
Personnel costs		
Salaries and other remuneration	501	712
Social security expenses (of which pension obligations) ¹	(194)	(197)
Total	927	1,220

1) SEK 8 million (7) of the pension costs are attributable to the group comprising current senior executive officers and former senior executive officers. The company's outstanding pension obligations attributable to these officers total SEK 44 million (41).

None of the Board members receives any pension benefits in connection with Board duties.

Note 31 Contingent liabilities

	2005	2004
Guarantees		
of which:		
for Vattenfall Treasury's lending:		
to subsidiaries	20,797	18,519
to associated companies	36	37
external borrowing for subsidiaries	58,991	51,665
external borrowing for other companies	14	14
subordinated guarantees	48	40
Swedish Nuclear Waste Fund	5,377	3,779
Contract guarantees	677	761
Other guarantees	9,182	4,436
Total	95,122	79,251
Other contingent liabilities		
Compensatory and free power deliveries:		
Wholesale power deliveries		
Number of commitments	13	13
Power MW	223	17
Energy deliveries, TWh/year	0.9	0.9

SEK 91,088 million (78,900) of the parent company's contingent liabilities are attributable to its subsidiaries. Vattenfall AB has guaranteed Vattenfall Treasury AB's commitments.

As security for the energy trading of the subsidiary Vattenfall Europe Trading GmbH, Vattenfall AB has provided guarantees to a total value of EUR 525 million (140), equivalent to SEK 4,951 million (1,256). On the balance sheet date, utilised guarantees totalling EUR 271 million (14), equivalent to SEK 2,558 million (124), were included in the reported contingent liabilities.

See also Note 43 of the consolidated accounts.

	2005			2004		
	Board members and senior executive officers ¹	Others employees	Total	Board members and senior executive officers ¹	Others employees	Total
Salaries and other remuneration						
Sweden	24	477	501	16	693	709
Other countries	–	–	0	–	3	3
Total²	24	477	501	16	696	712

1) Board members and senior executive officers also include alternates, vice presidents and former Board members, alternates, presidents and vice presidents.

2) Total salaries and other remuneration to Board members and presidents include bonuses of SEK 8 million (2).

For benefits to senior executive management within Vattenfall, see Note 45 of the consolidated accounts.

Note 34 Absenteeism through sickness

Absenteeism through sickness as a percentage of normal working hours throughout the year.

	Parent company Vattenfall AB		Vattenfall Group, Swedish operations	
	2005	2004	2005	2004
Total absenteeism through sickness	3.5	4.0	4.1	4.0
Absenteeism through sickness:				
–for women	6.2	7.1	6.3	6.6
–for men	2.2	2.3	3.4	3.3
–for those aged 29 and younger	4.5	4.9	3.4	3.4
–for those aged 30–49 years	3.4	4.2	3.6	3.4
–for those aged 50 and above	2.9	3.3	5.3	4.7
Percentage of absenteeism through sickness lasting 60 days or more	38.6	41.0	43.8	49.0

Note 35 Gender distribution among executive management

	Women, %		Men, %	
	2005	2004	2005	2004
Gender distribution among Board members	15	14	85	86
Gender distribution among other executive management	10	10	90	90

Note 36 Leasing

Leasing expenses

Future payment commitments, as of 31 December 2005, for leasing contracts and rental contracts break down as follows:

	Financial leasing	Operating leasing
2006	–	12
2007	–	10
Total	0	22

Leasing expenses for the year attributable to the parent company amounted to SEK 11 million (11).

Leasing revenues

Vattenfall AB owns and operates energy facilities on behalf of customers. Revenues from customers breaks down into two components – a fixed component to cover capital expenses and a variable component based on the quantity delivered.

Facilities are classified in accordance with standard leasing principles, based on the fixed revenue component.

On 31 December 2005, cost of assets reported under Operating leasing amounted to SEK 1,016 million (1,219). Accumulated depreciation amounted to SEK –341 million (–342) and accumulated impairment losses to SEK –30 million (–30). A number of facilities were sold to a subsidiary during the year.

Future payments for this type of facility break down as follows:

	Financial leasing	Operating leasing
2006	1	47
2007	1	43
2008	1	41
2009	1	39
2010	1	34
2011 and beyond	5	238
Less: Financial income	–4	–175
Total	6	267

Note 37 Remuneration to auditors etc.

	2005	2004
Statutory audit		
Ernst & Young	7	6
Swedish National Audit Office	1	1
Total	8	7
Other remuneration		
Ernst & Young ¹	5	5
PricewaterhouseCoopers	1	1
Total	6	6

1) About SEK 3 million (3) is attributable to consultations for personnel based outside Sweden.

Note 38 Transactions with related parties

See Note 49 of the consolidated accounts.

PROPOSED DISTRIBUTION OF PROFITS

The Annual General Meeting has at its disposal profits totalling SEK 16,080,834,124.

The Board of Directors and Chief Executive Officer propose that the profits should be distributed as follows

To be distributed to the shareholders, SEK	5,800,000,000
To be carried forward, SEK	10,280,834,124
	<hr/>
	16,080,834,124

The proposed distribution is equivalent to a dividend of SEK 44.04 per share.

Statement by the Board of Directors pursuant to the Swedish Companies Act (ABL) Chapter 18 Section 4

Based on the Company's and the Group's strong financial situation, good results and strong cash position the Board of Directors considers that the proposed distribution of profits will not lead to any significant restriction in the Company's or Group's capacity to

make possible necessary investments or to fulfil its obligations in the short and long-term.

The proposed distribution has no significant affect on the Company's key ratios either.

In the light of the above, the Board of Directors considers the proposed distribution of profits of SEK 5,800,000,000 carefully planned and justified. The Board of Directors further considers that the proposed distribution of profits adheres to the framework for the prescribed dividend policy. (See page 7).

The Board of Directors and the Chief Executive Officer's affirmation upon signing the annual accounts for the year 2005

We affirm that the annual accounts, as far as we know are prepared in accordance with generally accepted accounting principles, that the information provided corresponds with the state of affairs and that nothing of material importance is omitted which could affect the view of the company presented by the annual accounts.

Stockholm 22 February 2006

Dag Klackenborg
Chairman of the Board

Maarit Aarni Carl-Gustaf Angelin Johnny Bernhardsson Christer Bådholm

Ronny Ekwall Peter Lindell Hans-Olov Olsson

Lone Fønss Schrøder Anders Sundström

Lars G Josefsson
President and Chief Executive Officer

AUDIT REPORT

To the annual meeting of the shareholders of Vattenfall AB

Corporate identity number 556036-2138

We have audited the annual accounts, the consolidated accounts, the accounting records and the administration of the board of directors and the managing director of Vattenfall AB for the year 2005. The board of directors and the managing director are responsible for these accounts and the administration of the company as well as for the application of the Annual Accounts Act when preparing the annual accounts and the application of international financial reporting standards IFRSs as adopted by the EU and the Annual Accounts Act when preparing the consolidated accounts. Our responsibility is to express an opinion on the annual accounts and the consolidated accounts comprising pages 64–112 and the administration based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Sweden. Those standards require that we plan and perform the audit to obtain reasonable assurance that the annual accounts and the consolidated accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the accounts. An audit also includes assessing the accounting principles used and their application by the board of directors and the managing director and significant estimates made by the board of directors and the managing director when preparing the annual accounts and consolidated accounts as well as evaluating the overall presentation of informa-

tion in the annual accounts and the consolidated accounts. As a basis for our opinion concerning discharge from liability, we examined significant decisions, actions taken and circumstances of the company in order to be able to determine the liability, if any, to the company of any board member or the managing director. We also examined whether any board member or the managing director has, in any other way, acted in contravention of the Companies Act, the Annual Accounts Act or the Articles of Association. We believe that our audit provides a reasonable basis for our opinion set out below.

The annual accounts have been prepared in accordance with the Annual Accounts Act and give a true and fair view of the company's financial position and results of operations in accordance with generally accepted accounting principles in Sweden. The consolidated accounts have been prepared in accordance with the international financial reporting standards IFRSs as adopted by the EU and the Annual Accounts Act and give a true and fair view of the group's financial position and results of operations. The statutory administration report is consistent with the other parts of the annual accounts and the consolidated accounts.

We recommend to the annual meeting of shareholders that the income statements and balance sheets of the parent company and the group be adopted, that the profit of the parent company be dealt with in accordance with the proposal in the administration report and that the members of the board of directors and the managing director be discharged from liability for the financial year.

Stockholm, February 22, 2006

Ernst & Young AB
Lars Träff
Authorized Public Accountant

Per Redemo
Authorized Public Accountant
Riksrevisionen

DEFINITIONS AND CALCULATIONS OF KEY RATIOS

Figures for the Group in 2005. Amounts in SEK millions unless otherwise stated.

EBIT Earnings Before Interest and Tax.

EBITDA Earnings Before Interest, Tax, Depreciation and Amortisation.

FFO Funds From Operations.

Items affecting comparability Non-recurring capital gains and capital losses from shares and other non-current assets as well as restructuring costs for 2004 which, according to Swedish GAAP, were recorded as an offset of negative goodwill. For 2005, the compensation received from the Swedish state for the closing of Barsebäck 2 and relevant costs for the impairment losses of the assets are also reported as items affecting comparability.

Net assets Balance sheet total less non interest-bearing liabilities, provisions, interest-bearing receivables, funds in the Swedish Nuclear Waste Fund, cash and cash equivalents plus short-term investments.

Net debt Interest-bearing liabilities less long-term loans to minority owners in foreign subsidiaries and cash and cash equivalents plus short-term investments.

Operating margin, per cent

Operating profit (EBIT)	27,730
Net sales	129,158
	<u>21.5</u>

Operating margin excl items affecting comparability, per cent

Operating profit (EBIT) excl items affecting comparability	24,744
Net sales	129,158
	<u>19.2</u>

Pre-tax profit margin, per cent

Profit before tax	26,319
Net sales	129,158
	<u>20.4</u>

Pre-tax profit margin excl items affecting comparability, per cent

Profit before tax excl items affecting comparability	23,325
Net sales	129,158
	<u>18.1</u>

Return on equity, per cent

Profit for the year attributable to shareholders of the parent company	19,235
Equity attributable to shareholders of the parent company excl the hedging reserve (Balance brought forward)	72,994
	<u>26.4</u>

Return on equity excluding items affecting comparability, per cent

Profit for the year attributable to shareholders of the parent company excluding items affecting comparability	16,081
Equity attributable to shareholders of the parent company excl the hedging reserve (Balance brought forward)	72,994
	<u>22.0</u>

Return on net assets, per cent

Operating profit (EBIT) plus discounting effects attributable to provisions	25,670
Weighted average of net assets for the year	143,001
	<u>18.0</u>

Return on net assets excl items affecting comparability, per cent

Operating profit (EBIT) excl items affecting comparability plus discounting effects attributable to provisions	22,684
Weighted average of net assets for the year	143,001
	<u>15.9</u>

Interest coverage ratio, times

Operating profit (EBIT) plus financial income excl discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund	29,451
Financial expenses excl discounting effects attributable to provisions	3,161
	<u>9.3</u>

Interest coverage ratio excl items affecting comparability, times

Operating profit (EBIT) excl items affecting comparability plus financial income excl discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund	26,465
Financial expenses excl discounting effects attributable to provisions	3,161
	<u>8.4</u>

FFO interest coverage ratio, times

Funds from operations (FFO) plus financial expenses excl discounting effects attributable to provisions	34,547
Financial expenses excl discounting effects attributable to provisions	3,161
	<u>10.9</u>

FFO interest coverage ratio, net, times

Funds from operations (FFO) plus financial items excl discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund	32,826
Financial items excl discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund	1,440
	<u>22.8</u>

Equity/assets ratio, per cent

Equity	88,466
Balance sheet total less interest arbitrage transactions	330,421
	<u>26.8</u>

Net debt/equity ratio, times

Net debt	64,343
Equity	88,466
	<u>0.73</u>

Net debt/net debt plus equity, per cent

Net debt	64,343
Net debt plus equity	152,809
	<u>42.1</u>

Interest-bearing liabilities/ interest-bearing liabilities plus equity, per cent

Interest-bearing liabilities	78,663
Interest-bearing liabilities plus equity	167,129
	<u>47.1</u>

Funds from operations (FFO)/ interest-bearing liabilities, per cent

Funds from operations (FFO)	31,386
Interest-bearing liabilities	78,663
	<u>39.9</u>

Funds from operations (FFO)/net debt, per cent

Funds from operations (FFO)	31,386
Net debt	64,343
	<u>48.8</u>

EBITDA/net financial items, times

EBITDA	42,542
Financial items excl discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund	1,440
	<u>29.5</u>

EBITDA/net financial items excl items affecting comparability, times

EBITDA excl items affecting comparability	39,556
Financial items excl discounting effects attributable to provisions and returns from the Swedish Nuclear Waste Fund	1,440
	<u>27.5</u>

Free cash flow

Cash flow from operating activities	24,423
Maintenance investments	10,082
	<u>14,341</u>

EIGHT-YEAR REVIEW

Amounts in SEK millions	IFRS		Swedish GAAP						
	2005	2004	2004	2003	2002	2001	2000	1999	1998
Income statement items									
Net sales	129,158	113,366	113,366	111,935	101,025	69,003	31,695	27,754	27,957
EBITDA	42,542	32,386	31,453	24,878	24,855	18,250	12,165	9,866	9,860
Operating profit (EBIT)	27,730	17,112	19,607	15,296	13,363	9,959	6,688	5,515	6,067
Operating profit (EBIT) ¹	24,744	19,327	18,788	15,033	12,916	8,822	4,969	5,515	6,067
Financial income	3,810	2,969	1,772	2,267	3,010	2,232	1,037	542	288
Financial expenses	-5,221	-5,467	-4,020	-5,203	-6,386	-4,737	-2,536	-1,760	-1,907
Profit before tax	26,319	14,614	17,359	12,360	9,987	7,454	5,189	4,297	4,448
Profit for the year	20,518	9,604	12,348	9,529	8,224	5,287	3,432	2,897	2,632
- of which attributable to shareholders of the parent company	19,235	8,944	11,776	9,123	7,566	4,190	2,970	2,538	2,664
- of which attributable to minority interests	1,283	660	572	406	658	1,097	462	359	-32
Cash flow items									
Funds from operations (FFO)	31,386	24,302	24,159	18,804	17,106	13,148	5,830	6,224	6,758
Free cash flow	14,341	15,684	15,684	11,606	10,820	5,478	3,050	1,326	4,320
Balance sheet items									
Cash and cash equivalents and short-term investments	14,074	13,616	13,616	14,647	15,473	10,340	7,543	4,860	4,439
Equity	88,466	83,108	62,316	52,506	45,129	39,578	35,374	33,347	32,325
- of which attributable to shareholders of the parent company	78,122	72,994	53,128	43,127	35,169	20,498	30,389	30,875	30,112
- of which attributable to minority interests	10,344	10,114	9,188	9,379	9,960	19,080	4,985	2,472	2,213
Interest-bearing liabilities	78,663	73,013	73,013	85,631	94,838	88,723	50,854	32,275	27,876
Net debt	64,343	55,411	55,411	66,890	75,207	55,736	43,311	27,415	23,437
Interest-bearing provisions	47,691	45,491	-	-	-	-	-	-	-
Non-interest-bearing liabilities and provisions	115,601	83,593	112,398	117,449	126,349	111,662	24,046	18,569	20,942
Net assets, weighted average value	143,001	134,125	123,423	124,229	127,479	100,701	74,968	60,395	57,253
Balance sheet total	330,421	285,205	256,915	264,965	276,276	259,043	115,259	86,663	83,356
Key ratios (per cent unless otherwise stated)									
Operating margin	21.5	15.1	17.3	13.7	13.2	14.4	21.1	19.9	21.7
Operating margin ¹	19.2	17.0	16.6	13.4	12.8	12.8	15.7	19.9	21.7
Pre-tax profit margin	20.4	12.9	15.3	11.0	9.9	10.8	16.4	15.5	15.9
Pre-tax profit margin ¹	18.1	14.8	14.6	10.8	9.4	9.2	10.5	15.4	15.9
Return on equity	26.4	13.7	22.4	20.2	19.1	11.8	8.9	7.9	8.5
Return on equity ¹	22.0	15.6	21.4	19.8	18.3	10.3	4.2	7.8	8.6
Return on net assets	18.0	11.6	15.9	12.3	10.5	9.9	8.9	9.1	10.6
Return on net assets ¹	15.9	13.3	15.2	12.1	10.1	8.8	6.6	9.1	10.6
Interest coverage ratio, times	9.3	5.3	5.3	3.4	2.6	2.6	3.0	3.4	3.3
Interest coverage ratio, times ¹	8.4	5.9	5.1	3.3	2.5	2.3	2.3	3.4	3.4
FFO interest coverage ratio, times	10.9	8.0	7.0	4.6	3.7	3.8	3.3	4.5	4.5
FFO interest coverage ratio, net, times	22.8	11.8	11.7	7.4	6.1	6.3	4.9	6.1	5.2
Equity/assets ratio	26.8	29.1	27.8	23.4	20.0	22.7	35.4	42.3	42.2
Net debt/equity ratio	0.73	0.67	0.77	1.08	1.37	0.95	1.07	0.77	0.68
Net debt/net debt plus equity	42.1	40.0	43.7	51.9	57.7	48.7	51.8	43.4	40.4
Interest-bearing liabilities/interest-bearing liabilities plus equity	47.1	46.8	50.5	58.0	63.2	60.1	55.8	46.4	41.0
FFO/interest-bearing liabilities	39.9	33.3	33.1	22.0	18.0	14.8	11.5	19.3	24.2
FFO/net debt	48.8	43.9	43.6	28.1	22.7	23.6	13.5	22.7	28.8
EBITDA/net financial items, times	29.5	14.4	14.0	8.5	7.4	7.3	8.1	8.1	6.1
EBITDA/net financial items, times ¹	27.5	15.4	13.6	8.3	7.2	6.9	6.4	7.9	6.1
Other information									
Dividends to shareholders in the parent company	5,800 ²	5,600	5,600	2,400	1,675	1,030	990	1,500	1,500
Investments	24,497	12,731	12,601	11,356	39,932	43,443	23,840	7,916	4,528
Electricity sales, TWh	200.3	186.4	186.4	184.2	188.3	149.9	83.1	86.9	83.8
Average number employees	32,231	33,017	33,017	35,296	34,248	23,814	13,123	7,991	7,996

1) Excl. items affecting comparability

2) Proposed dividend.

Comments

Since 2000, Vattenfall's sales have almost quadrupled, the result of the acquisition of the major German energy companies HEW, Bewag, Veag and Laubag and the Polish companies EW and GZE.

Assets have more than doubled in the same period. Operating profit has increased from SEK 6.7 billion in 2000 to SEK 27.7 billion in 2005, mostly due to very successful integration and consolidation work, but also due to effective hedging of electricity generation. During the years 2004–2005, higher electricity wholesale prices, primarily in Germany, also contributed to higher sales and profits.

QUARTERLY REVIEW

Amounts in SEK millions (IFRS)	2005				2004			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Income statement items								
Net sales	37,280	27,550	29,292	35,036	32,405	23,890	25,261	31,810
EBITDA	14,183	6,770	8,943	12,646	8,432	5,477	7,299	11,178
Operating profit (EBIT)	10,264	3,266	4,981	9,219	3,790	2,062	3,619	7,641
Operating profit (EBIT) ¹	7,264	3,276	5,008	9,196	5,001	2,621	3,764	7,941
Financial income	1,903	771	592	544	1,289	624	617	439
Financial expenses	-1,494	-1,218	-1,375	-1,134	-1,438	-1,203	-1,524	-1,302
Profit before tax	10,673	2,819	4,198	8,629	3,641	1,483	2,712	6,778
Profit for the period	10,175	1,857	2,917	5,569	2,172	873	1,666	4,893
– of which attributable to shareholders of the parent company	9,444	1,814	2,793	5,184	1,904	990	1,525	4,525
– of which attributable to minority interests	731	43	124	385	268	-117	141	368
Cash flow items								
Funds from operations (FFO)	12,674	3,921	6,020	8,771	6,780	2,794	5,719	9,009
Free cash flow	389	5,129	2,809	6,014	1,552	3,856	3,771	6,505
Balance sheet items								
Cash and cash equivalents and short-term investments	14,074	16,815	14,953	15,950	13,616	15,868	16,558	13,028
Equity	88,466	80,497	79,598	86,544	83,108	80,260	79,261	80,712
– of which attributable to shareholders of the parent company	78,122	70,888	68,955	76,006	72,994	70,701	69,541	70,944
– of which attributable to minority interests	10,344	9,609	10,643	10,538	10,114	9,559	9,720	9,768
Interest-bearing liabilities	78,663	80,921	87,358	71,389	73,013	77,703	82,141	80,124
Net debt	64,343	63,800	68,307	51,395	55,411	57,850	61,512	62,916
Interest-bearing provisions	47,691	45,466	45,787	45,372	45,491	46,061	47,761	48,234
Non-interest-bearing liabilities and provisions	115,601	115,836	112,293	100,663	83,593	85,708	85,081	88,136
Net assets, weighted average value ²	143,001	138,307	134,767	133,391	134,125	–	–	–
Balance sheet total	330,421	322,720	325,036	303,968	285,205	289,732	294,244	297,206
Key ratios (per cent unless otherwise stated)								
Operating margin	27.5	11.9	17.0	26.3	11.7	8.6	14.3	24.0
Operating margin ¹	19.5	11.9	17.1	26.2	15.4	11.0	14.9	25.0
Pre-tax profit margin	28.6	10.2	14.3	24.6	11.2	6.2	10.7	21.3
Pre-tax profit margin ¹	20.6	10.3	14.4	24.6	15.0	8.5	11.3	22.3
Return on equity ²	26.4	16.5	15.6	13.5	13.7	–	–	–
Return on equity ^{1,2}	22.0	17.6	17.1	15.1	15.6	–	–	–
Return on net assets ²	18.0	14.1	13.7	12.8	11.6	–	–	–
Return on net assets ^{1,2}	15.9	15.0	15.0	14.2	13.3	–	–	–
Interest coverage ratio, times	10.7	5.4	6.3	15.4	4.0	3.8	4.6	8.2
Interest coverage ratio, times ¹	7.8	5.4	6.3	15.4	5.2	4.7	4.8	8.6
FFO interest coverage ratio, times	13.3	6.8	8.2	15.3	7.6	5.5	7.6	10.4
FFO interest coverage ratio, net, times	54.7	16.0	11.8	23.9	10.5	9.4	12.1	14.1
Equity/assets ratio	26.8	24.9	24.5	28.5	29.1	27.8	27.0	27.2
Net debt/equity ratio	0.73	0.79	0.86	0.59	0.67	0.72	0.78	0.78
Net debt/net debt plus equity	42.1	44.2	46.2	37.3	40.0	41.9	43.7	43.8
Interest-bearing liabilities/interest-bearing liabilities plus equity	47.1	50.1	52.3	45.2	46.8	49.2	50.9	49.8
FFO/interest-bearing liabilities ²	39.9	31.5	27.9	33.7	33.3	–	–	–
FFO/net debt ²	48.8	40.0	35.7	46.8	43.9	–	–	–
EBITDA/net financial items, times	60.1	25.8	16.0	33.0	11.9	16.4	14.2	16.2
EBITDA/net financial items, times ¹	47.4	25.9	16.0	33.0	13.6	18.1	14.5	16.6
Other information								
Investments	4,729	4,432	13,515	1,821	4,046	2,755	2,667	3,263
Electricity sales, TWh	53.7	44.5	46.7	55.4	49.6	41.3	43.3	52.2
Average number employees	32,231	32,428	32,113	32,170	35,296	33,116	33,110	33,228

1) Excl. items affecting comparability

2) Rolling 12-month values (IFRS information for 2003 has not been calculated)

Comments

Vattenfall's financial performance varies considerably over the year. The greater part of the year's profit is normally generated during the first and fourth quarters when demand for electricity and heating peaks.

GLOSSARY

Shared power Several parties have the right to electricity from a particular power plant.

Deregulation Abolishing monopoly rights and obligations to open up for competition. Used here as a synonym for liberalisation.

CSR Corporate Social Responsibility – a concept whereby companies integrate economical, social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.

Derivative Instruments Financial instruments wherein the value or change in value is related to an underlying instrument. Examples of derivative instruments include options, forwards and swaps. Derivative instruments are often used in risk management.

Deep repository Underground facility for the final disposal of spent nuclear fuel. See also SKB's website <http://www.skb.se>.

DSO Abbreviation of Distribution System Operator. Responsible for operating, ensuring the maintenance of and developing the distribution system in a given area (compare with TSO).

EBIT Earnings Before Interest and Tax (operating profit).

EBITDA Earnings Before Interest, Tax, Depreciation and Amortisation of goodwill (operating profit before depreciation).

EDF The largest power company in France and Europe.

EEX European Energy Exchange, the German electricity exchange. Head office in Leipzig.

Electrabel The largest power company in the Benelux countries.

Electricity spot market Short-term physical trading in electricity on an exchange.

EMAS Eco Management and Audit Scheme. European Commission regulations for environmental management and auditing.

EnBW One of Germany's four largest power companies.

Endesa The largest power company in Spain.

Enel The largest power company in Italy.

E.ON One of Germany's four largest power companies and also one of the majority owners of E.ON Sverige (formerly Sydkraft).

EPD Environmental Product Declaration. A system based on Type III declarations.

ISO TR 14025 which aims at providing objective, credible and comparable information on the environmental impact of products and services. See also www.environdec.com.

Replacement power Replacement delivery, in accordance with a riparian court decision, to the owner of another power station on the same river.

EU 25 The 25 member countries constituting the European Union after the latest enlargement (1 May 2004).

EW Elektrociepłownia Warszawskie S.A., Polish subsidiary of Vattenfall. The company changed named to Vattenfall on 1 January 2006.

Ex-ante tariff regulation The approval of tariffs prior to implementation.

Ex-post tariff regulation Tariffs are examined by the regulator after implementation.

FFO Funds From Operations.

Fortum The largest power company in Finland.

Renewable energy sources Non-finite energy sources such as hydro power, biofuel, wind, solar power, tidal power, wave power, geothermal power.

Green Certificates Tradable certificates issued for renewable energy.

GZE Górnoslaski Zakład Elektroenergetyczny S. A., Polish subsidiary of Vattenfall.

ISDA agreement A bilateral general agreement prepared in accordance with guidelines established by the International Swap Dealers Association. The agreement regulates the parties' legal obligations in derivative transactions with each other.

ISO 14001 International standard for environmental management systems.

CHP Combined heat and power plant. A plant that generates heat and electricity in the same process.

Kyoto accord International agreement to reduce greenhouse gas emissions.

Legal unbundling Legal separation of transmission and distribution from other activities (generation/sales).

Lignite Brown coal.

Local network An electricity network in Sweden within the 0.4–20 kV range.

Merit order The order in which capacity is put into use.

Nord Pool The Nordic electricity exchange.

NTPA Abbreviation of Negotiated Third Party Access. Access to the network granted on the basis of bilateral negotiations between the network owner and the network user.

OTC Over the Counter. Trading (directly or via a broker) outside the official exchanges in physical and financial contracts.

POLPX The Polish electricity exchange, Towarowa Gielda Energii.

Regional network An electricity network in Sweden within the 40–130 kV range.

PSE Polskie Sieci Elektroenergetyczne – Polish Power Grid Company.

RTPA Abbreviation of Regulated Third Party Access. Access to the network is provided based on published and regulated tariffs for the use of the network.

RWE One of Germany's four largest power companies.

SKB Svensk Kärnbränslehantering AB, the party responsible for managing radioactive waste in Sweden.

Spot market A market where trade is conducted with immediate delivery.

Statkraft The largest power company in Norway.

Major disruption Extensive disruptions in electricity network operations which result in many customers lacking electricity.

Swap A financial instrument that is a combination of spot and forward transactions, a type of financial exchange agreement.

Forward market A market in which buyers and sellers agree on a fixed price for the future delivery of an underlying instrument, such as electricity. (See also Derivative Instruments).

Availability Actual electricity generation capability in relation to the maximum possible generation.

Regulator The legal authority that supervises the market to ensure effective competition and fair pricing.

TSO Abbreviation of Transmission System Operator. Responsible for operating, ensuring the maintenance of and developing the transmission system in a given area (compare with DSO).

Unbundling Separation of the transmission/distribution system interests from the other interests of a company.

Volatility A measure of the extent to which the price of a commodity varies over a particular period.

Value chain Process for creating value. Within the electricity sector this includes the generation, transmission, distribution and selling of electricity.

Thermal power Electricity generated via a heating process, such as a gas turbine or a steam process in a coal-fired or nuclear power plant (compare with CHP).

Retailer Firm at the end of the distribution chain, which normally buys a product from a wholesaler in order to sell it to the final consumer.

ABOUT ENERGY

Energy terms

Units of power

Power is energy per unit of time

Power is expressed in Watts (W)

1 kW (kilowatt) = 1,000 W

1 MW (megawatt) = 1,000 kW

1 GW (gigawatt) = 1,000,000 kW

Units of energy

Energy is power multiplied by time

1 kWh (kilowatt hour) = 1 kW expended over an hour

1 MWh (megawatt-hour) = 1,000 kWh

1 GWh (gigawatt-hour) = 1,000,000 kWh

1 TWh (terawatt-hour) = 1,000,000,000 kWh

Voltage

1 kV (kilovolt) = 1,000 volt (V)

Energy units in practice

1 kWh is enough to run a standard Swedish car heater for about an hour or an 11 W low energy light bulb for almost four days.

1 MWh is enough to heat a small house for a couple of weeks and is generated in 20 minutes by Vattenfall's largest wind turbine in windy conditions.

1 GWh is enough to meet the energy needs of an average Swedish town with a population of 100,000 for 8 hours and can be generated in one hour by the Harsprånget hydro plant or in 20 minutes by the Forsmark nuclear power plant.

1 TWh is enough to run two large news print machines for a year. It is also enough to power all of Sweden's railways, underground railways and trams for five months. Ringhals nuclear power plant can generate this power in 12 days.

FIVE AMBITIONS FOR BECOMING NUMBER ONE

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